

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

126

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA

No. 16,479

PANHANDLE EASTERN PIPE LINE

v.

FEDERAL POWER COMMISSION,

Respondent.

On Petition to Review and Set Aside Order of the Federal Power
Commission

**INITIAL BRIEF FOR PETITIONER
PANHANDLE EASTERN PIPE LINE COMPANY**

HARRY S. LITTMAN
DALE A. WRIGHT
RICHARD LITTELL
317 Wyatt Building
Washington 5, D. C.

JOSEPH J. DANIELS
Baker & Daniels
810 Fletcher Trust Building
Indianapolis 4, Indiana

ROBERT P. PATTERSON, JR.
Patterson, Belknap & Webb
1 Wall Street
New York 5, New York

*Attorneys for Panhandle Eastern
Pipe Line Company*

October 19, 1961

Statement of Questions Presented

1. In fixing rates under the Natural Gas Act, may the Federal Power Commission deprive a natural-gas company of the major portion of the benefits of its tax accruals resulting from accelerated amortization and liberalized depreciation under Internal Revenue Code Sections 167 and 168, when such deprivation is contrary to the intent of Congress and to judicially-approved Commission decisions?

2. If a natural-gas company has sought, obtained, and relied upon Commission rulings that the benefits of tax accruals under Sections 167 and 168 belonged to it, may the Commission deprive a company of the major portion of these benefits?

3. Was the Commission's treatment of tax accruals resulting from accelerated amortization and liberalized depreciation supported by substantial evidence and proper findings?

4. Even if it is lawful for the Commission to deprive a natural-gas company of any part of the benefits of accelerated amortization and liberalized depreciation, may the Commission refuse to permit the company to earn a return on its deferred tax accruals sufficient to produce a result which, as this Court stated in *City of Detroit v. F.P.C.*,¹ "neither aids nor harms" the company's customers?

¹ 97 App. D.C. 260, 272, 220 F. 2d 810, 822 (1955), cert. denied 352 U.S. 829.

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INITIAL BRIEF FOR PETITIONER
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JURISDICTIONAL STATEMENT

This appeal was instituted by the filing of a Petition to Review by Petitioner, Panhandle Eastern Pipe Line Company (Panhandle), pursuant to Section 19(b) of the Natural Gas Act (52 Stat. 831; 15 U.S.C. 717r(b)) for the purpose of reviewing and setting aside an order of the Federal Power Commission (Commission). This order is

entitled "Order Determining Rate of Return, Disallowing Proposed Increased Rates, Directing Payment of Refunds, and Permitting Substitution of Lower Interim Rates," and was issued March 20, 1961 in Docket No. G-19780 (R. 3551-5).²

On April 19, 1961, within the time prescribed by Section 19(a) of the Natural Gas Act, Panhandle filed an Application for Rehearing of such order (R. 3556-68), which was denied by order issued May 15, 1961 (R. 3590). Thereafter, on July 12, 1961, and within the time provided for by the Natural Gas Act, Panhandle filed its Petition to Review with this Court.

The jurisdiction of the Court is provided for by Section 19(b) of the Natural Gas Act (52 Stat. 831; 15 U.S.C. 717r(b)).

STATEMENT OF THE CASE

Panhandle owns and operates a natural gas pipeline system extending in a northeasterly direction from Texas to Michigan. The rates charged by Panhandle for the sale of natural gas for resale in interstate commerce are subject to the jurisdiction of the Federal Power Commission as provided by the Natural Gas Act.

Panhandle is appealing an order of the Federal Power Commission which changes its treatment of funds made available to Panhandle by Sections 167 and 168 of the Internal Revenue Code (R. 3553-5).

Sections 167 and 168

In 1950 Congress, in an effort to inject more capital into the economy and to encourage construction of certain facilities, enacted what is now Section 168 of the Internal Revenue Code. In 1954 it enacted Section 167 to encourage

²"(R.)" refers to the page of the record certified by the Commission to this Court. The "(R.)" pages will be printed in the Joint Appendix.

expansion of the nation's productive facilities. Under these sections, a company may elect to amortize or depreciate certain facilities for tax purposes at a faster rate than would be possible under normal ("straight-line") depreciation, and, consequently, to defer a portion of its tax payments to the Treasury during the early years of operation of such property. As compared with straight-line depreciation, the use of Sections 167 and 168 for tax purposes permits a company to accrue deferred tax funds which may be invested in new productive facilities upon which the company may earn a return.

**Commission's Prior Treatment of
Sections 167 and 168**

In August, 1952, before electing to use the benefits provided by Section 168, Panhandle initiated a proceeding before the Commission for a declaratory order to determine whether Panhandle would be allowed to retain the tax benefits which would result if it were to adopt accelerated amortization under what is now Section 168 (R. 1757). On December 4, 1953, after expanding that proceeding into a rule-making determination in which Panhandle fully participated, the Commission issued its Opinion No. 264.³ It there enunciated the general rule that pipeline companies would be allowed to retain all the benefits resulting from accelerated amortization and that none of these benefits would be passed on to utility customers. Thereafter, and in reliance on the rules adopted by the Commission, Panhandle elected to use accelerated amortization for Federal income tax purposes and constructed new facilities with funds thus accumulated (R. 1757-9).

With respect to Section 167 the Commission held similar hearings and issued its order on June 30, 1956 in the

³ *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 F.P.C. 369 (1953).

*Amere*⁴ case, in which Panhandle fully participated as an intervenor. The Commission there ruled that liberalized depreciation should be accorded the same treatment as that accorded to accelerated amortization in its Opinion No. 264. It was only thereafter, and in reliance thereon, that Panhandle elected to use liberalized depreciation for Federal income tax purposes and decided to build numerous facilities with funds so derived (R. 1758-9).

In later decisions, both the Commission and this Court specifically confirmed that Panhandle was entitled to retain the benefits of what is now Section 168.⁵ Thereafter, the Commission also reaffirmed its similar ruling regarding Section 167.⁶

The Order Under Review

On September 10, 1959, Panhandle filed with the Commission, pursuant to Section 4(d) of the Natural Gas Act, schedules of new rates reflecting a 7 percent over-all rate of return on its transmission properties. After hearings, the Commission severed the rate of return issue for immediate decision and, on March 20, 1961, issued the interim order under review (R. 3551).

By such order, the Commission required Panhandle to file interim rates reflecting a 6¼ percent over-all return on its transmission properties. The Commission's action in reducing Panhandle's claimed 7 per cent over-all rate of return to 6¼ percent was the result of two conclusions, namely (1) that Panhandle should be allowed a return of 10.47 percent on its common equity instead of 11.76 percent as claimed by Panhandle (a matter which is not here

⁴ *Amere Gas Utilities Co., et al.*, 15 F.P.C. 781 (1956).

⁵ *Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53, 81-4 (1954), *aff'd as to accelerated amortization sub. nom. City of Detroit v. F.P.C.*, 97 App. D.C. 260, 230 F. 2d 810, *cert. denied*, 352 U.S. 829.

⁶ *El Paso Natural Gas Co.*, 22 F.P.C. 260 (1959); *United Fuel Gas Co.*, 23 F.P.C. 127, 131 (1960); *Phillips Petroleum Co.*, 24 F.P.C. 537, 570 (1960).

in issue); and (2) that the over-all return should not be computed on the basis of a conventional statement of actual capitalization in accordance with past Commission practice, but rather on the basis of including Panhandle's accumulated tax accruals resulting from the use of Sections 167 and 168 in the capitalization statement at a return of only 1.5 percent (R. 3551). It is the Commission's decision regarding treatment of these tax accruals that is the subject of the instant appeal.

In taking the position that Panhandle must include the amounts accumulated for deferred taxes in its statement of capitalization and that "a net return of only 1.5 percent should be attributed to such amounts" (R. 3551), the Commission relied solely on its Opinion No. 342, *Northern Natural Gas Co.*, _____ F.P.C. _____, Docket No. G-19040, March 7, 1961⁷ and its Opinion No. 343, *Kansas-Nebraska Natural Gas Company, Inc.*, _____ F.P.C. _____, Docket No. G-12391, March 8, 1961. In its Opinion No. 342 (at *mimeo.*, p. 10), the Commission admitted that it had decided "to divide the benefits of liberalized depreciation between the regulated company and the ratepayer," with "the major portion of the benefits going" to the customer. It followed the same rule regarding accelerated amortization in Opinion No. 343 without further explanation.

STATUTES INVOLVED

The statutes involved are Sections 167 and 168 of the Internal Revenue Code of 1954 (Act of August 16, 1954, c. 736, 68 A Stat. 51-52, U.S.C.A., Title 26, §§ 167-168). Since these sections are lengthy, they are set out in Appendix B hereto.

⁷ *Northern Natural Gas Co.*, Opinion No. 342, Docket No. G-19040, Opinion issued March 7, 1961, *appeals docketed, sub nom., Northern Natural Gas Co. v. F.P.C.*, No. 16421, D.C. Cir., June 16, 1961, and *Public Service Comm. of Wisconsin v. F.P.C.*, No. 16397, D.C. Cir., June 2, 1961. Commissioner Kuykendall concurred in the order under review but stated that he adhered to his dissent in the *Northern Natural* Opinion. For the Court's convenience, mimeographed copies of the Commission's Opinion Nos. 342 and 343 will be lodged with the Clerk.

STATEMENT OF POINTS

1. The Commission erred in depriving Panhandle of the major portion of the benefits of accelerated amortization and liberalized depreciation when the intent of Congress and judicially-approved Commission decisions clearly require that Panhandle be permitted to retain the benefits thereof.

2. The Commission's treatment of Panhandle's deferred tax accruals is arbitrary and capricious and constitutes an abuse of discretion in view of the fact that, in electing to use accelerated amortization and liberalized depreciation, Panhandle requested, obtained and relied upon Commission determinations that it would be permitted to retain the benefits thereof.

3. The Commission's treatment of Panhandle's tax accruals is not supported by any evidence or by proper findings, and therefore is unlawful.

4. Even if the Commission may deprive Panhandle of any part of the benefits of accelerated amortization or liberalized depreciation, the Commission erred in failing to allow a return on such tax accruals to Panhandle which "neither aids nor harms" its customers.

SUMMARY OF ARGUMENT

In enacting Sections 167 and 168 of the Internal Revenue Code, Congress permitted the taxpayer to depreciate or amortize certain facilities at a faster rate for tax purposes than would otherwise be possible. Because the Commission continues to compute its tax allowance for rate-making purposes on the basis of normal (straight-line) depreciation, a natural-gas company's use of Sections 167 and 168 permits it to retain the use of funds by means of a tax deferral. In this way, Congress intended to provide an incentive to American industry, including the natural-gas pipeline industry, to expand facilities and ca-

capacity. As this Court and the Commission have recognized, Congress' intent in Sections 167 and 168 was not to benefit utility customers, but rather to benefit the taxpayers.

The Commission's refusal to allow Panhandle a full return of 6.46 percent on its tax accruals thwarts Congress' intent by depriving Panhandle of the major portion of the benefits of accelerated amortization and liberalized depreciation. By dividing such benefits between Panhandle and its utility customers, with the major portion of such benefits going to the customers, the Commission disregarded the intent of Congress and prior decisions of the Commission and this Court that such benefits were intended to be retained by the taxpayer and should not be passed on to its customers, either directly or indirectly. In particular, the Commission's order produces a result which differs only in form and degree from the proposal rejected as unlawful by this Court in *City of Detroit v. F.P.C.*, 97 U.S. App. D.C. 260, 230 F. 2d 810 (1955), *cert. denied*, 352 U.S. 829.

The arbitrary and capricious nature of the Commission's action is emphasized by the fact that, before electing to use the accelerated amortization and liberalized depreciation provisions of the Internal Revenue Code, Panhandle requested, obtained and relied upon the Commission's determinations, in proceedings in which it was a party, that Panhandle would be permitted to retain the benefits thereof. By its present effort to disregard such past determinations, the Commission would impose a severe penalty upon Panhandle. For Panhandle could have earned substantially more than the Commission would now allow on such funds if, instead of electing to use the statutory benefits of Sections 167 and 168, Panhandle had raised such funds from its normal capital sources. Since the decisions on which Panhandle relied have been judicially affirmed, the Commission's retroactive

action is especially arbitrary and unlawful with regard to Panhandle.

The Commission's treatment of tax accruals is supported neither by any evidence in the record nor by proper findings. Thus, the Commission erred in asserting that to permit the company to use its accrued tax funds for income-producing purposes would result in higher rates to its customers. It so erred because it compared such costs with the costs which would have resulted if, instead of electing to use accelerated amortization and liberalized depreciation, the company had raised the same amount of capital solely by debt financing, an admittedly unrealistic assumption, as such funds are more akin to equity capital. Similarly, the Commission failed to make proper findings to support its conclusion that the return which it allowed on such tax accruals would provide a sufficient incentive to induce a regulated company to take advantage of the provisions of Sections 167 and 168.

Even if the Commission may lawfully deprive Panhandle of any part of the benefits of accelerated amortization and liberalized depreciation, the Commission erred in failing to allow Panhandle a return of at least 5.45 percent on the deferred tax accruals and the related over-all return of at least 6.41 percent. As shown in Appendix A hereto, the allowance of a return of 5.45 percent on Panhandle's accrued taxes is the minimum necessary to produce the result which "neither aids nor harms" its utility customers. *City of Detroit, supra*. Such a return results in precisely the same annual cost to Panhandle's customers as if Panhandle had not elected to take advantage of accelerated amortization or liberalized depreciation but, instead, had raised the same amount of capital by the issuance of debt, preferred stock, and common equity in the same proportions and at the same costs and returns as the company's actual existing capitalization.

ARGUMENT

I

THE COMMISSION COMMITTED REVERSIBLE ERROR BY DEPRIVING PANHANDLE OF BENEFITS OF DEFERRED TAXES CONTRARY TO INTENT OF CONGRESS.

In Opinion No. 342 in *Northern Natural Gas Co.*, on which the Commission relied in deciding this case, the Commission admitted it was deciding "to divide the benefits of liberalized depreciation between the regulated company and the ratepayer." It stated:

"* * * we believe that the major portion of the benefits accruing from the use of liberalized depreciation should go to the ratepayer, and the company should be allowed only so much of the benefits accruing from the use of liberalized depreciation as is necessary to provide it with a sufficient incentive to continue to use liberalized depreciation, and not to return to the use of straight-line depreciation in the computation of its income taxes." *Northern Natural Gas Co.*, Opinion No. 342, issued March 7, 1961 (*mimeo.*, p. 10), *appeals docketed sub nom. Northern Natural Gas Co. v. F.P.C.*, No. 16421, D.C. Cir., June 16, 1961, and *Public Service Comm. of Wisconsin v. F.P.C.*, No. 16397, D.C. Cir., June 2, 1961.

The Commission, without elaborating upon its reasons, also decided to treat accelerated amortization in the same manner. *Kansas-Nebraska Natural Gas Company, Inc.*, Opinion No. 343, issued March 8, 1961.

Such treatment is clearly contrary to the intent of Congress that the taxpayer is entitled to the benefits of liberalized depreciation and accelerated amortization.

A. The Commission Has Used An Artificial Statement of Capitalization in Order to Deprive Panhandle of Benefits Which Congress Intended for the Company.

Traditionally, the Commission and the courts have determined the fair rate of return on the basis of a pipeline company's actual capitalization of long-term debt, pre-

ferred stock, and common equity. Now, however, the Commission has decided that "a factual statement of the pipeline company's capital should include the amounts accumulated in the restricted account for deferred taxes and that a net return of 1.5 percent should be attributed to such amounts" (R. 3551). The Commission's decision treats Panhandle's actual capitalization of \$257,927,825 as though it included the further amount of \$11,076,954 accrued deferred taxes which, pursuant to Commission rules, are required to be segregated in special restricted accounts.⁸ In short, the Commission has employed an artificial statement of capitalization in order to deprive Panhandle of the major portion of the benefits of its tax accruals.

In order to appreciate fully how the Commission has thus subverted the intent of Congress, some explanation of the origin and purpose of Panhandle's tax accruals is appropriate. Panhandle had accumulated the \$11,076,954 deferred tax account as a result of its elections to accrue \$6,960,095 accelerated amortization and \$4,116,859 liberalized depreciation under Sections 167 and 168 of the Internal Revenue Code (R. 1756). Under these sections, a taxpayer may elect to depreciate or amortize certain facilities at a faster rate for tax purposes than otherwise would be possible. This allows the taxpayer to take larger annual deductions for tax purposes during the early years of the property and, accordingly, to reduce its taxable income and taxes payable during such years. Under the Commission's rate-making procedures, the taxpayer's use of Sections 167 and 168 permits the taxpayer to accrue tax funds which need not be paid to the Treasury during such early years. These accruals constitute a tax deferral, not a tax saving. *El Paso Natural Gas Co. v. F.P.C.*, 281 F. 2d 567, 573 (5 Cir. 1960), *cert. denied*, 366

⁸ See Sections 281 and 282 of the Commission's Uniform System of Accounts under the Natural Gas Act, 18 C.F.R. 201.281 and 201.282.

U.S. 912; *City of Detroit v. F.P.C.*, 97 App. D.C. 260, 230 F. 2d 810 (D.C. Cir. 1955), *cert. denied*, 352 U.S. 829.

As this Court and the Commission have recognized, Congress' intent in Sections 167 and 168 was *not* to benefit a pipeline's utility customers. *City of Detroit v. F.P.C.*, *supra*, at 822; *El Paso Natural Gas Co.*, 22 F.P.C. 260, 266 (1959). Rather, Congress intended these sections to apply to "all segments of the American economy," including regulated natural-gas pipelines like Panhandle. S. Rep. No. 1622, 83rd Cong., 2d Sess. 26 (1954); H. Rep. No. 1337, 83rd Cong., 2d Sess. 24 (1954). See S. Rep. No. 154, 83rd Cong., 1st Sess. 1 (1953). See also *Amere Gas Utilities Co.*, 15 F.P.C. 781, 782 (1956); *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 F.P.C. 369, 370 (1953).

By its enactment of Sections 167 and 168, Congress intended to make available funds in order to encourage expansion and construction of facilities and capacity by the taxpayer. *El Paso Natural Gas Co.*, *supra*; *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, *supra*; *Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53, 82 (1954).

In making these funds available, Congress obviously intended that industry should earn a full return thereon. Otherwise there would be no incentive to accumulate such funds to build new facilities or to expand.

B. The Commission Has Now Departed from Its Judicially-Approved Prior Decisions That It Was Controlled by Congress' Intent That Taxpayers Should Retain the Benefits of Sections 167 and 168.

Prior to its decision in *Northern Natural Gas Co.*, *supra*, the Commission had consistently held, as a matter of law, that Congress intended that Sections 167 and 168 were to benefit the taxpayer and not utility customers. The Commission has held repeatedly that it was obligated to give effect to such Congressional intention.

The Commission first considered and gave effect to this Congressional intent when it promulgated its Opinion No. 264, in which it ruled that the benefits of accelerated amortization under what is now Section 168 (previously Section 124A) should be retained by the taxpayer, rather than be passed on to its customers. *Treatment of Federal Income Taxes as Affected by Accelerated Amortization, supra.*

After Panhandle elected to utilize accelerated amortization, the Commission specifically decided in Panhandle's rate case in Docket No. G-1116 that such benefits could not be passed on to its customers. *Panhandle Eastern Pipe Line Co., supra*, at 81-4. This Court upheld the Commission in this regard. *City of Detroit v. F.P.C., supra.* It stated (230 F. 2d at 822) that the Commission had correctly concluded that:

"... the intent of Congress reflected in Section 124A is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities. Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of the deferred taxes to accrue after the five year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from section 124A (footnote omitted). This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. . . ."

Subsequently, with respect to the benefits of liberalized depreciation provided for in Section 167, the Commission

uniformly decided that liberalized depreciation should be accorded the same treatment as that which accelerated amortization had received. *Amere Gas Utilities Co.*, 15 F.P.C. 781 (1956); *El Paso Natural Gas Co.*, 22 F.P.C. 260 (1959), *aff'd as to this issue*, 281 F. 2d 567 (5 Cir. 1960), *cert. denied*, 366 U.S. 912; *United Fuel Gas Co.*, 23 F.P.C. 127 (1960), *aff'd Cities of Lexington, Kentucky, et al. v. F.P.C.*, _____ F. 2d _____ (4 Cir., Case No. 8101), decided October 2, 1961.

In *El Paso Natural Gas Co.*, *supra*, the Commission stated (22 F.P.C. 260 at 266):

"* * * As the United States Court of Appeals noted in the *City of Detroit* case (footnote omitted) with respect to the account for accumulated deferred taxes created in connection with accelerated amortization, the intent of Congress was not to benefit consumers, but to encourage construction. * * * We concluded in the *Amere* case that *we could not strike down an Act of Congress and we must apply Section 167 to the natural gas companies*. As stated in our order we would call the situation to the attention of Congress by transmitting copies of the presiding examiner's decision and our order to the Chairman of the Finance Committee of the Senate and the Chairman of the Ways and Means Committee of the House, and we did so by our letter dated July 2, 1956. Since that time Congress has not amended the Internal Revenue Code or the Natural Gas Act in this respect, thus affirming our interpretation of its intentions. * * *"
22 F.P.C. 260, 266.⁹

As late as September 28, 1960, in *Phillips Petroleum Co.*, 24 F.P.C. 537, the Commission again made plain that the benefits resulting from the use of accelerated amortization were intended for and should be retained by the taxpayer and not passed on to its customers. There it specifically rejected its Staff's proposal which, like its decision here, would artificially treat the accrued taxes as though they

⁹ Emphasis is supplied throughout this Brief unless otherwise indicated.

were a part of the company's capitalization and allow a return thereon at less than the full over-all rate. In reaching a result totally inconsistent with its treatment here of Panhandle's tax accruals, the Commission there stated (24 F.P.C. at 570):

"There was no dispute about these figures, but the Staff contended that Phillips' actual debt ratio and actual cost of debt should be adjusted to reflect as an interest-free loan an item of deferred Federal income tax liability in the amount of \$19,162,355, arising from the accelerated amortization provisions of Section 168 of the Internal Revenue Code. This would decrease Phillips' cost of debt to 2.76 percent. The examiner refused to make this adjustment, and we agree. The accelerated amortization provisions were to benefit the taxpayer, not the consumers. They represent an advantage bestowed by Congress to encourage the construction of emergency facilities, and *we are not authorized to take away this advantage.* * * *"

Thus in *Phillips*—as in Docket No. G-1116—the Commission derived the fair rate of return on the basis of the company's actual capitalization, without including deferred tax accruals. This, of course, is precisely the method advocated by Panhandle in the instant proceeding.

Nothing has occurred since the *Phillips* case to justify the Commission's sudden departure from its long line of decisions upholding the right of the taxpayer to the benefits of accelerated amortization and liberalized depreciation. Certainly Congress has not abandoned the intention which underlies Sections 167 and 168. The Commission's treatment of Panhandle's tax accruals cannot be reconciled with its many prior decisions on the same subject. Furthermore, its action is directly contrary to the decision of this Court in *City of Detroit, supra*.

C. The Commission's New Position Is a Device to Circumvent This Court's Holding in the City of Detroit Case.

In *City of Detroit v. F.P.C.*, *supra*, this Court upheld the Commission's decision that Panhandle was entitled to retain the benefits of what is now Section 168. In rejecting the City of Detroit's position that Panhandle should not be allowed to earn a full return on its tax accruals, this Court held that such a result would be contrary to the controlling intent of Congress. This Court said:

"Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. *The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings.* In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated." 230 F. 2d 810, 822.

Thus, in *City of Detroit*, this Court was fully aware of the nature of the benefits it decided belonged to Panhandle. It rejected the contention of City of Detroit that a fast write-off in a short period of time was the sole benefit to be conferred on Panhandle, 230 F. 2d 810, 822, fn. 17, and held that the right to earn income while such tax deferrals were accruing was a benefit which must be effectuated in accordance with Congressional intent. It continued:

"* * * The funds go into a reserve account for the payment of the deferred taxes to accrue after the five year amortization period. *Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from Section 124A.* This statute unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress (footnote omitted)." 230 F. 2d 810, 822.

The same rate of return allowed by the Commission and the Court in the *City of Detroit* case was applied to Panhandle's entire investment in transmission properties, in-

cluding that part financed by deferred taxes. In the instant case the Commission is now attempting to subvert the Congressional intent in a manner which it categorically rejected as beyond its authority in the *Phillips* decision, discussed above.

Instead of calculating the over-all rate of return in its traditional manner by calculating the cost of Panhandle's actual capitalization of debt, preferred stock, and common equity, as it did in the *City of Detroit* case, the Commission has diluted this actual capitalization by adding thereto deferred taxes at an arbitrary return of 1.5 percent. As a result, Panhandle is permitted a return of only 1.5 percent on its accumulated deferred taxes and a full rate of return only on the remainder of its invested capital. The Commission thus accomplishes the same effect as would be produced by deducting 77 percent of the deferred tax accruals from the rate base.¹⁰ By indirection, the Commission now seeks to reach a result which, of course, differs only in degree from the proposal to deduct 100 percent of such accruals from the rate base held improper by this Court in the *City of Detroit* case.

In these circumstances, the Commission's decision clearly must be set aside. If the Commission's determination of the over-all rate of return for Panhandle were corrected so as to permit Panhandle to retain the benefits of accelerated amortization and liberalized depreciation as intended by Congress, by excluding the deferred tax accruals which were improperly treated by the Commission as a part of Panhandle's capitalization, the resulting over-

¹⁰ The portion of the deferred tax accruals included in the rate base under the Commission's method is determined by dividing the return of 1.5 percent allowed on such tax accruals by the overall return of 6.46 percent which Panhandle is entitled to earn thereon (see footnote 11, *infra*) (1.5 divided by 6.46 equals .2322 or 23.22%). The balance, or 76.78%, is the portion of the tax accruals excluded from the rate base.

all return would be 6.46 percent, as calculated below,¹¹ instead of the 6.25 percent which the Commission allowed. Accordingly, the Commission erred in failing to allow to Panhandle an over-all rate of return of at least 6.46 percent on its transmission properties and in ordering Panhandle to file rates based upon a lower rate of return.

II

THE COMMISSION'S DEPARTURE FROM ITS PRIOR DETERMINATIONS THAT PANHANDLE IS ENTITLED TO RETAIN THE BENEFITS OF ACCELERATED AMORTIZATION AND LIBERALIZED DEPRECIATION IS ARBITRARY AND CAPRICIOUS.

The Administrative Procedure Act requires that acts of administrative bodies be set aside if they are "arbitrary or capricious." Sec. 10, 60 Stat. 243; 5 U.S.C. Sec. 1009(e). By this standard, the Commission acted unlawfully in departing from its own judicially-approved decisions which Panhandle sought, obtained, and relied upon.

A. Panhandle Sought, Obtained, and Relied Upon the Commission's Determinations That Panhandle Would Be Permitted to Retain the Benefits of Sections 167 and 168.

When Sections 167 and 168 were first enacted in 1950 and 1954, respectively, Panhandle did not rush in eagerly to claim the benefits they made available. Before deciding to elect accelerated amortization, Panhandle applied to the Commission for a declaratory order concerning the effect such an election would have for rate purposes (R. 1757). Panhandle fully participated in the resulting proceedings and took the position that, in the absence of a favorable decision on the part of the Commission, it would not feel justified in making the election. It was not until

¹¹	Amount	Ratio	Cost	Return
Long-Term Debt	\$140,878,000	54.62%	3.55	1.94
Preferred Stock	9,377,700	3.64%	3.99	.15
Common Equity	107,672,125	41.74%	10.47	4.37
Over-all Return				6.46%

after the Commission issued its Opinion No. 264, discussed above, that Panhandle made its election to utilize accelerated amortization (R. 1758).

Panhandle's decision to use liberalized depreciation has a similar history. Panhandle intervened and actively participated in the *Amere* case (R. 1758), wherein it took the position before the Commission that it could not elect to adopt the depreciation methods provided by Section 167 of the Internal Revenue Code unless it was assured of retaining the full benefits available under the statute (R. 1758). After the Commission there determined that liberalized depreciation should be accorded the same treatment as accelerated amortization, Panhandle proceeded with its election to use the liberalized depreciation methods approved by Congress (R. 1759).

In reliance upon this consistent body of rule making, Panhandle accumulated \$11,076,954 accrued taxes under Sections 167 and 168 which it reinvested in additional facilities. By reducing Panhandle's earnings on such properties from a full return to a token 1.5 percent, the Commission would severely penalize Panhandle. For as even the Commission conceded in Opinion No. 342 (at *mimeo.*, pages 11-12), a natural-gas company could have earned substantially more than 1.5 percent on such facilities if it had not elected to finance them by the use of statutory benefits of Sections 167 and 168, but instead, had raised such capital from "average industry sources."

When there is such detrimental reliance, similar retroactive agency action has been struck down as arbitrary and capricious and, therefore, beyond the power of government agencies. *U. S. v. Atlantic Refining Co.*, 360 U.S. 19 (1959); *Chapman v. El Paso Natural Gas Co.*, 89 App. D.C. 267, 204 F. 2d 46 (D.C. Cir. 1953); *H. S. D. Co. v. Kavanagh*, 191 F. 2d 831 (6 Cir. 1951); *Vestal v. Comm'r.*, 80 App. D.C. 269, 152 F. 2d 132 (D.C. Cir. 1945).

It is too late now to undo tax elections made in some cases many years ago, and to recast those elections in the light of the Commission's new position. In the future Panhandle and other taxpayers subject to the Commission's jurisdiction will be unable to rely on the provisions of Section 167 when considering new construction, for if they may lose 77% of the benefits today, they may well find that tomorrow the Commission has deprived them of 99%. Furthermore, if any new tax incentives are enacted by Congress during the present emergency, those companies subject to the Commission's decision would neither be able to rely on them nor be induced by them to fulfill the purposes of Congress.

B. The Commission's Rationalizations Do Not Justify Its Departure from Its Past Determinations Regarding Accelerated Amortization and Liberalized Depreciation.

By disregarding its own past treatment of tax accruals, the Commission is attempting to overturn the rule laid down by this Court in the *City of Detroit* case. This is especially plain because the instant proceeding involves the same accruals on facilities which were the subject of the *City of Detroit* case, as well as further accruals on these same facilities and similar accruals made on facilities which were built in reliance on the Commission's and the Court's holding in that case.

In such circumstances, it is clear that the Commission may not thus depart from its prior determinations which have been judicially approved. *In re Federal Water & Gas Corp.*, 188 F. 2d 100, 104 (3 Cir. 1950); *N.L.R.B. v. Brown & Root*, 203 F. 2d 139 (8 Cir. 1953). *Accord. Sunshine Anthracite Coal v. Adkins*, 310 U.S. 381 (1940).

The Commission attempts to justify its disregard for its past treatment of these tax accruals in two equally specious ways. First, the Commission attempts to disguise the true nature of its action in the present case by rephrasing the issue. Thus the Commission states: "Our

previous determinations with respect to the treatment of liberalized depreciation have not dealt with the computation of rate of return but rather the question of the normalization of taxes" (Opinion No. 342, *mimeo.*, page 4).

The Court should not be thrown off by this contrived tactic. Regardless of how phrased, the real issue here and in the prior Commission decisions is whether Panhandle is entitled to the benefit of the tax deferrals provided by Sections 167 and 168. It is immaterial whether this issue arises in the context of a determination of cost of service or a determination of rate of return. The plain fact is that in order for Panhandle to benefit equally with other taxpayers from Sections 167 and 168, it must be allowed not only to retain the funds temporarily generated under those sections, but also to invest those funds and earn a full return thereon, as shown above. This was recognized in *City of Detroit*. To allow Panhandle to retain the funds but deny it a full return on them is merely to take back with the left hand something which has been given by the right.

In any event, the Commission's assertion that its past decisions "have not dealt with the computation of rate of return" is incorrect. As shown above, in the *Phillips* case the Commission recently rejected a proposal which, like its decision here, would have reduced the company's rate of return by treating the tax accruals as though they were a part of the Company's capitalization. There it clearly recognized that such a proposal "constitutes a device designed to pass on to the rate payers a portion of the tax savings which both the Commission and the Court of Appeals in the *City of Detroit* case have held was intended by Congress to inure to the benefit of the certificate holder." 24 F.P.C. at 741.

Secondly, in attempting to avoid the force of the *City of Detroit* case, which admittedly supports the company's position (Opinion No. 342, *mimeo.*, page 8), the Commis-

sion also advances the theory that that case was wrongly decided. According to the Commission, "neither [it] nor the courts were fully aware" that to permit Panhandle to retain the use of these funds for income-producing purposes would, as a logical consequence, give rise to income taxes which would be passed on to Panhandle's customers as a normal cost of service (*Id.* at *mimeo.*, pages 8-9).

It is unreasonable to say that when the earlier decisions were made, the Commission was not fully aware of its own procedures requiring inclusion of income taxes in determining a company's cost of service. There is nothing new about this. An allowance for income taxes has been included in every rate set by the Commission since it first began fixing rates. Accordingly, it is only reasonable to presume that the members of the Commission who were sitting at the time of the earlier decisions were fully aware of their own rules and the normal consequences thereof. This is especially true when the prior proceedings involved so basic a matter as the treatment of income tax in the computation of cost of service.

The Commission is on equally unsound ground in asserting that this Court, in reaching its decision in the *City of Detroit* case, was "not fully aware" of the consequences of its decision. This Court is also familiar with rate-making procedures and knows that income taxes on earnings are included in cost of service. More important, the effect of corporate income taxes was specifically called to the Court's attention. In its initial brief to the Court (page 96, note 38), the City of Detroit plainly pointed out that unless its position were adopted, Panhandle would be permitted to receive revenues equal not only to a fair return of \$484,468, on the accrued tax reserve itself, but also an additional \$535,657 for "associated income taxes at the 52% rate ($484,468 \times 1.0833$)."

Certainly there is no justification for the Commission's contention in Opinion No. 342 that this Court wrongly decided the *City of*

Detroit case because it was not "fully aware of" the "additional sum of 108.33 percent" required for income taxes.

III.

THE COMMISSION'S ACTION IN DEPRIVING PANHANDLE OF THE MAJOR PART OF THE BENEFITS OF DEFERRED TAXES IS NOT SUPPORTED BY ANY EVIDENCE OR PROPER FINDINGS AND, THEREFORE, IS UNLAWFUL.

While the Commission erroneously seeks to support its order by reference to Opinion No. 342 in *Northern Natural Gas Company, supra*, and Opinion No. 343 in *Kansas-Nebraska Natural Gas Company, supra*, the findings therein on the treatment of deferred taxes are erroneous in fact and law, are not supported by substantial evidence in this record and do not provide a lawful basis for the Commission's determination to deprive Panhandle of substantially all of the benefits of accelerated amortization and liberalized depreciation.

A. The Commission's Assertion That the Customers "Would Be Penalized" by Allowing Panhandle a Full Return on Its Deferred Tax Accruals Is Erroneous and Unsupported.

The Commission's action in depriving Panhandle of substantially all of the benefits of its deferred tax accruals is bottomed upon its assertion that "the statement in . . . the *City of Detroit* case that to permit the company to use the funds for income-producing purposes would not result in higher rates to the consumer has on more careful consideration been disclosed to be erroneous" (Opinion 342 at *mimeo.*, page 8). The Commission purports to support this conclusion that it and the Courts have erred in a series of decisions from 1954 to 1960 by the assumption that, if the company had not elected to use accelerated amortization and liberalized depreciation, the facilities which were constructed by the utilization of the deferred tax accruals would have been financed solely by means of debt capital (Opinion 342 at *mimeo.*, p. 9). Such assump-

tion is erroneous and without any support whatever in the record. The Commission itself acknowledged that "it [is] unrealistic to assume that a company would borrow as senior capital all of the moneys needed by it * * *" (*Id.* at 9). The Commission emphasized the fallacy in this assumption in its further statement that "it is probably neither fair nor realistic to assume that [the company] will borrow all of this money" (*Id.* at 11).

Indeed, it would be more realistic to conclude that, in the absence of deferred tax accruals, the facilities which were constructed with such accruals would have been financed entirely by common equity capital. For as [then] Chairman Kuykendall appropriately stated in his dissent to Opinion No. 342 (*mimeo.*, page 1):

"* * * Such funds [deferred tax accruals] actually are as much or more akin to equity capital than to debt capital. We recognized this fact in our Order No. 203 amending our uniform system of accounts, 19 FPC 826, when we considered the possibility of setting up the reserve account as earmarked surplus. Our prohibition against payment of dividends from these funds would seem to presuppose that such sums are included in surplus."

It is obvious that, if Panhandle had financed such facilities entirely by equity capital upon which the Commission allowed Panhandle a 10.47 percent return after income taxes (R. 3552-3), the total annual cost to its customers of the funds represented by the deferred tax accruals would have far exceeded the cost to the consumer which results from the allowance of the over-all rate of return of 6.46 percent after income taxes upon such funds as required by the *City of Detroit* case and as requested by Panhandle. On this more realistic basis, Panhandle's election to utilize the deferred tax provisions and to devote the resulting accumulated funds to income-producing purposes has resulted in a substantial saving and benefit to its utility customers.

B. The Commission's Finding That 1.5 Percent Return Would Constitute a Sufficient Incentive Is Erroneous and Unsupported.

In Opinion No. 342, the Commission held that "a return of 1.5 percent on moneys in the deferred tax account is a sufficient incentive to a regulated company to induce it to take advantage of the provisions of Section 167" (*Id.*, at 10-11). The Commission said that this conclusion "is supported by various computations" (*Id.* at 11). These computations are fallacious, without any support in the record, and, in any event, fail to substantiate the Commission's ultimate finding.

In its first computation in Opinion No. 342, the Commission purported to show (*mimeo.*, page 11) that provisions of a 1.5 percent return would allow the company to earn approximately the same amount on its accrued taxes as it could have earned if it had borrowed these funds instead of electing to take advantage of the statutory incentives. But, as shown above, the Commission's assumption that the facilities constructed by the utilization of deferred tax accruals would be financed solely by means of debt capital if the tax accruals were unavailable is clearly erroneous and unsupported.

The Commission's second computation purported to show the return which an "average" major pipeline company would have earned if it had not elected to use the statutory benefits and, instead, had raised such capital "from average industry sources" (*Id.* at 11). But as shown on the Commission's tabulation on page 12 of Opinion No. 342,¹² the company's common shareholders would have earned a substantially higher return on such funds in these circumstances than the 1.5 percent which the Commission allowed. Thus, the Commission's second compu-

¹² The Commission's tabulation understates the return and revenue loss which would result to Panhandle because it assumes an average industry capitalization containing less equity than is present in Panhandle's capitalization.

tation fails to support the Commission's ultimate finding and furnishes positive proof that the Commission has provided an insufficient return.

Lastly, the Commission stated that its conclusion was supported by a number of factors "apart from earnings" (*Id.* at 13). Whatever weight these factors might have for Northern, there is still nothing in this record to show that they would constitute an incentive for Panhandle, which the Commission found to be "one of the strongest of the major pipelines" (R. 3552). Moreover, as to Panhandle, the Commission's conclusion that such considerations would provide an adequate incentive is directly contrary to the uncontradicted evidence showing that Panhandle repeatedly insisted from the beginning that it would not elect to take advantage of Sections 167 and 168 unless it was assured that it would be permitted to retain the full benefits thereof (R. 1757-9).

It is thus apparent that a Commission allowance of an arbitrary return of 1.5 percent on Panhandle's deferred tax accruals is erroneous, unsupported by findings or evidence, and thus unlawful. Indeed, what the Commission did here, in essence, was to substitute its unsupported judgment as to the required incentive for that of Congress.

The characterization of the amount of incentive by the Commission as "a matter of judgment" does not relieve it of the duty to make "basic findings supported by evidence and ultimate findings which flow rationally from the basic findings." *Capital Transit Co. v. P.U.C.*, 93 App. D.C. 194, 213 F. 2d 176, 187 (D.C. Cir. 1954), *cert. denied* 348 U.S. 816. As stated in *Mississippi River Fuel Corp. v. F.P.C.*, 82 App. D.C. 208, 163 F. 2d 433, 439 (D.C. Cir. 1947):

"* * * The discretion and judgment confided in the Commission must be exercised upon facts and for reason. The duty of review imposed upon the courts

requires that the facts be found and the reasons stated. Otherwise, the courts cannot determine whether a given action is or is not arbitrary.

"The Congressional provisions extend to complicated, difficult matters as well as to simple questions. The courts cannot evade their responsibility merely because the subject matter is obscure. . . . When the matter is complicated, the necessity is greater."

See *Colorado-Wyoming Gas Co. v. F.P.C.*, 324 U.S. 626, 634 (1945).

The law is clear that the Court of Appeals should set aside an agency decision when it cannot find "the evidence supporting that decision is substantial, when viewed in the light that the record in its entirety furnishes, . . ." *Universal Camera Corp. v. N.L.R.B.*, 340 U.S. 474, 488 (1951). See Section 10(d) of the Administrative Procedure Act (60 Stat. 243, 5 U.S.C. 1009(e); Section 19(b) of the Natural Gas Act (52 Stat. 831; 15 U.S.C. 717r(b)).

IV.

EVEN IF THE COMMISSION MAY DEPRIVE PANHANDLE OF ANY PART OF THE BENEFITS OF SECTIONS 167 AND 168, THE COMMISSION ERRED IN ALLOWING LESS THAN A MINIMUM RETURN OF 5.45% ON PANHANDLE'S DEFERRED TAX ACCRUALS.

Even if it is lawful and proper to deprive Panhandle of any part of the benefits of accelerated amortization and liberalized depreciation, Panhandle is entitled to receive a return of at least 5.45% on its deferred tax accruals, and a minimum over-all return of 6.41 percent as shown below.

In its *Northern Natural* opinion (at *mimeo.*, pp. 8-9) upon which the Commission relied in the present proceeding, the Commission purported to base its decision upon this Court's statement in the *City of Detroit* case, *supra* (230 F. 2d at 822) that:

" . . . Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Pan-

handle but neither aids nor harms petitioners. We think this is the result sought by Congress."

It is clear, however, that the Commission's allowance of a return of 1.5 percent on Panhandle's deferred tax accruals produces the very opposite result from that intended by the above-quoted statement of the Court, since a return of 1.5 percent is not one which "neither aids nor harms" its customers. Indeed, it *aids* Panhandle's utility customers and *harms* Panhandle.

Any return on Panhandle's deferred tax accruals of less than 5.45 percent produces a result which aids its utility customers. This is demonstrated by Appendix A hereto, which shows the annual cost to the ratepayer resulting if Panhandle had not elected to utilize Sections 167 and 168 but, instead, had raised an equivalent amount of capital from the same sources, in the same proportions, and at the same cost as it had raised its other capital. This is consistent with the Commission's recognition that "it would be more fair to consider that additional moneys would be obtained without substantial change in the existing ratio between debt and equity . . ." (Opinion 342 at *mimeo.*, page 9).¹³ Appendix A also shows that a return of 5.45 percent on Panhandle's deferred tax accruals results in precisely the same annual cost to its customers as would result from this alternative method of raising capital.

It is clear that a return of 5.45 percent on the deferred tax accruals is the *minimum* that Panhandle should be allowed in order to achieve a result which "neither aids nor harms" its customers. Anything less would result in giving the customers a windfall by pre-empting to them

¹³ Chairman Kuykendall agreed that "The fairest and most logical assumption is that these amounts [deferred tax accruals] would have been obtained from the various sources in the same proportion as all of [the company's] other capital had been obtained (Opinion 342, dissent, *mimeo.*, page 2).

the major part of the tax benefits which this Court held in *City of Detroit* were intended for the taxpayer.

If the Commission's determination of the over-all rate of return for Panhandle were corrected so as to permit Panhandle to earn such minimum return of 5.45 percent on the deferred tax accruals, the over-all return for Panhandle of 6.25 percent allowed by the Commission would be increased to 6.41 percent, as demonstrated below.¹⁴

The minimum over-all return of 6.41 percent is most conservative. If Panhandle had resorted to the money market in recent years when the deferred taxes were actually accrued, it would have incurred substantially higher costs for financing than the *average historical imbedded* costs used in Appendix A. Adjustment of such *minimum* return for these higher costs, which Panhandle would have incurred and which its customers would have been required to pay had Panhandle not utilized Sections 167 and 168, emphasizes the Commission's error in failing to allow the 6.46 percent return required by the Commission's judicially-approved precedents. The Commission, therefore, clearly exceeded its authority and grossly abused its discretion in failing to allow Panhandle an over-all return on its transmission properties of 6.46 percent, or 6.41 percent as a conservative minimum, and in directing Panhandle to file rates based on a lower return.

¹⁴	Amount	Ratio	Cost	Return
Long-Term Debt	\$140,878,000	52.37%	3.55%	1.86%
Preferred Stock	9,377,700	3.49%	3.99	.14
Deferred Taxes	11,076,954	4.12%	5.45	.22
Common	107,672,124	40.02%	10.47	4.19
Over-all Return				6.41%

CONCLUSION

In view of the foregoing, it is apparent that the Commission's over-all rate of return allowance of 6.25 percent for Panhandle's transmission properties is unjust, unreasonable, confiscatory, unsupported by findings or substantial evidence and, therefore, unlawful. Accordingly, Panhandle respectfully requests that this Court reverse and set aside the Commission's Order of March 20, 1961, with respect to all matters complained of herein.

Respectfully submitted,

PANHANDLE EASTERN PIPE LINE COMPANY

By /s/ HARRY S. LITTMAN

Its Attorney

HARRY S. LITTMAN

DALE A. WRIGHT

RICHARD LITTELL

317 Wyatt Building

Washington 5, D. C.

JOSEPH J. DANIELS

Baker & Daniels

810 Fletcher Trust Building

Indianapolis 4, Indiana

ROBERT P. PATTERSON, JR.

Patterson, Belknap & Webb

1 Wall Street

New York 5, N. Y.

*Attorneys for Panhandle Eastern
Pipe Line Company*

October 19, 1961

APPENDIX A

Panhandle Eastern Pipe Line Company Docket No. G-19780

I

A. COMPUTATION OF OVER-ALL RETURN ON CAPITAL EQUAL
TO DEFERRED TAXES BASED ON PANHANDLE'S
CAPITALIZATION AT MAY 31, 1960

	Amount	Ratio	Cost	Return
Long Term Debt	\$ 6,050,232	54.62%	3.55%	1.94%
Preferred Stock	403,201	3.64%	3.99%	.15%
Common Equity	4,623,521	41.74%	10.47%	4.37%
Total	\$11,076,954			6.46%

B. COMPUTATION OF TOTAL ANNUAL INCOME AND INCOME
TAXES ON ABOVE

Income ($6.46\% \times \$11,076,954$)		\$ 715,600
Federal Income Tax		
Income as above	\$715,600	
Less Interest on Long Term Debt ($\$6,050,232 \times 3.55\%$)	214,800	
Taxable Income	\$500,800	
Tax at 108.333%		542,500
Total Income and Income tax		\$1,258,100

II

COMPUTATION SHOWING IDENTICAL TOTAL ANNUAL INCOME
AND INCOME TAXES WHEN USING 5.45% RETURN
ON DEFERRED TAX ACCRUALS

Income ($5.452\% \times \$11,076,954$)		\$ 603,900
Federal Income Tax		
Income as above	\$603,900	
Less Interest (0%)	—	
Taxable Income	\$603,900	
Tax at 108.333%		654,200
Total Income and Income Tax		\$1,258,100

EXPLANATORY NOTE

Computation I (Parts A and B), based on figures in the record and the Commission's order under review (R. 1752-4, 2497, 3553), shows the total income and income taxes in Panhandle's cost of service if it had raised the amount of tax deferrals (\$11,076,954) invested in facilities from the same sources, in the same ratios, and at the same costs as it had raised its other capital.

Part A shows the breakdown of funds equivalent in amount to the tax deferrals (\$11,076,954) into the proper proportions of long-term debt, preferred stock and common equity on this basis. Part B is a computation of the total of annual income and income taxes if the amount of tax deferrals (\$11,076,954) had been raised in the manner shown in Part A. The computation in Part B relates only to income and income taxes because other items in the cost of service would not change with a change in the method of raising capital.¹

Computation II is based on the same total annual income and income tax (\$1,258,100) shown in Computation I. Computation II proves that if Panhandle is allowed a return of 5.45% on its tax deferrals (\$11,076,954), the total cost to its utility customers (total income and income tax) is exactly equal to the total cost to its customers (\$1,258,100) on the basis of the method of raising capital utilized in Computation I.

¹ Reduction in working capital based on Federal income tax accruals and changes in state income taxes have been excluded because their effect on these calculations is insignificant.

APPENDIX B**Internal Revenue Code of 1954**

Act of Aug. 16, 1954, c. 736, as amended, 68A Stat. 51, 52,
26 U.S.C., §§ 167 and 168

Section 167

(a) General rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

- (1) of property used in the trade or business, or
- (2) of property held for the production of income.

(b) Use of certain methods and rates.—For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

- (1) the straight line method,
- (2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),
- (3) the sum of the years-digits method, and
- (4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) Limitations on use of certain methods and rates.—Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible prop-

erty) described in subsection (a) with a useful life of 3 years or more—

(1) the construction, reconstruction, or erection of which is completed after December 31, 1953, and then only to that portion of the basis which is properly attributable to such construction, reconstruction, or erection after December 31, 1953, or

(2) acquired after December 31, 1953, if the original use of such property commences with the taxpayer and commences after such date.

• • • • •

Section 168

(a) General rule.—Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any emergency facility (as defined in subsection (d)), based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction above provided with respect to any month shall, except to the extent provided in subsection (f), be in lieu of the depreciation deduction with respect to such facility for such month provided by section 167. The 60-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

(b) Election of amortization.—The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the month following the month in which the facility was completed or acquired, or with the taxable year succeeding the taxable year in which such facility was completed or acquired, shall be made by filing with the Secretary or his delegate, in such manner, in such form, and within such time, as the Secretary or his dele-

gate may by regulations prescribe, a statement of such election.

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(d) Definitions.—

(1) Emergency facility.—For purposes of this section, the term “emergency facility” means any facility, land, building, machinery, or equipment, or any part thereof, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1949, and with respect of which a certificate under subsection (e) has been made. In no event shall an amortization deduction be allowed in respect to any emergency facility for any taxable year unless a certificate in respect thereof under this paragraph shall have been made before the filing of the taxpayer’s return for such taxable year.

(2) Emergency period.—For purposes of this section, the term “emergency period” means the period beginning January 1, 1950, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities with respect to which certifications under subsection (e) have been made is no longer required in the interest of national defense.

(e) Determination of adjusted basis of emergency facility.—In determining, for purposes of subsection (a) or (g), the adjusted basis of an emergency facility—

(1) Certifications on or before August 22, 1957.—In the case of a certificate made on or before August 22, 1957, there shall be included only so much of the amount of the adjusted basis of such facility (computed without regard to this section) as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1949, as the certifying authority, designated by the President by Executive Order, has certified as necessary in the interest of national defense during the emergency period, and only such portion of such amount as such authority has certified as attributable to defense purposes. Such certification shall be under such regulations as may be prescribed from time to

time by such certifying authority with the approval of the President. An application for a certificate must be filed at such time and in such manner as may be prescribed by such certifying authority under such regulations, but in no event shall such certificate have any effect unless an application therefor is filed before March 24, 1951, or before the expiration of 6 months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition, whichever is later.

• • • • •

Amended Aug 26, 1957, Pub. L. 85—165, § 4, 71 Stat. 414;
Sept. 2, 1958, Pub. L. 85—866, Title I, § 9(a), (b), 72 Stat.
1608.

**BRIEF FOR RESPONDENT
FEDERAL POWER COMMISSION**

**IN THE
United States Court of Appeals
For the District of Columbia Circuit**

No. 16479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

**On Petition to Review an Order of the
Federal Power Commission**

RALPH S. SPRITZER,
General Counsel.

*United States Court of Appeals
For the
District of Columbia Circuit*

HOWARD E. WAHRENBROCK,
Solicitor,

FILED

JAN 29 1962

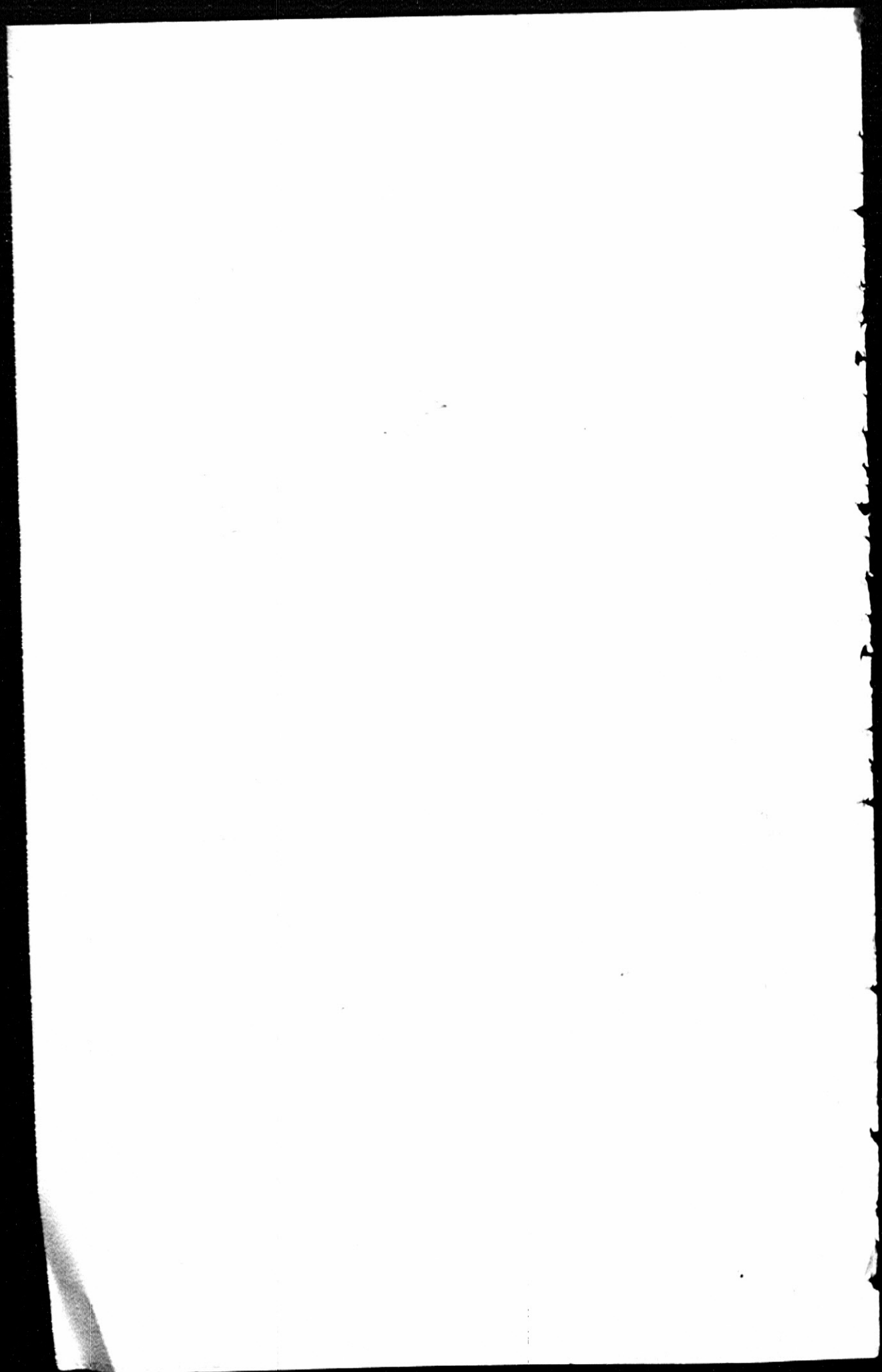
ABRAHAM R. SPALTER,
Assistant General Counsel,

JOSEPHINE H. KLEIN,
*Attorney,
For respondent.*

Federal Power Commission
Washington 25, D.C.

Joseph W. Stewart
CLERK

January 29, 1962



COUNTERSTATEMENT OF QUESTIONS INVOLVED

In the opinion of respondent, the questions presented are:

1. Whether the Commission abused its discretion in determining a fair rate of return on invested capital for the purpose of fixing rates by allowing only 1.5% per annum on that part of the capital which the company has accumulated out of revenues and placed in special accounts for the future payment of federal income taxes presently deferred by reason of the company's payment of such taxes under the liberalized depreciation and accelerated amortization methods permitted by Sections 167 and 168 of the Internal Revenue Code.

2. Whether previous Commission rulings and orders foreclosed it from exercising its judgment here in determining the amount of such allowance.

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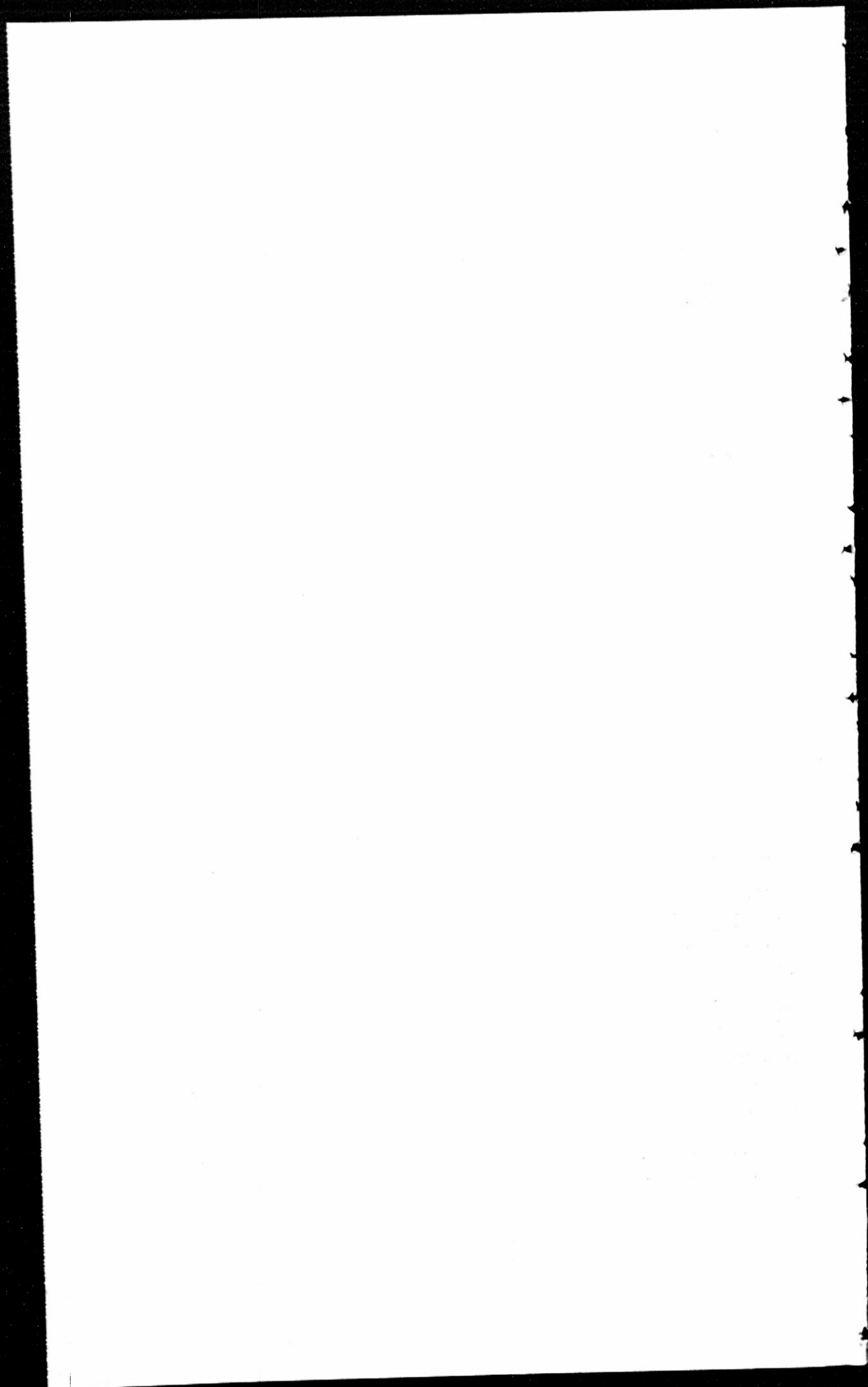
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IN THE
United States Court of Appeals
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No. 16479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

On Petition to Review an Order of the
Federal Power Commission

BRIEF FOR RESPONDENT
FEDERAL POWER COMMISSION

COUNTERSTATEMENT OF THE CASE

The Federal Power Commission order under review establishes a rate of return of 6.25% on Panhandle Eastern Pipe Line Company's transmission properties for determination of reasonable rates under Section 4(e) of the Natural Gas Act (June 21, 1938, c. 556, 52 Stat. 821-833, as amended 15 U.S.C. 717-717w). Reflected in that rate of return is an allowance of 1.5% on \$11,076,954 previously accumulated out of revenues and maintained in a special account entitled "Accumulated Deferred Taxes on Income."¹

¹ \$4,116,859 under Section 167; \$6,960,095 under Section 168. Section 167 is a continuing provision, whereas certification under Section 168 has terminated.

This \$11 million represents the difference between the normalized amount of federal income taxes which the Commission allows as an operating expense in fixing Panhandle's rates (the amount Panhandle would have paid if it had computed those taxes on the basis of conventional, straight-line depreciation) and the lower amount actually paid by the use of a method of liberalized depreciation authorized by Section 167 of the Internal Revenue Code and accelerated amortization under Section 168.

The methods of liberalized depreciation authorized under Section 167 all have the effect of allowing larger depreciation expenses during the early years of the life of depreciable property than in the later years. Thus, other factors remaining constant, during the early years of an asset's life liberalized depreciation results in lower federal income taxes than does straight-line depreciation, under which the depreciation expense is the same for each year of the asset's life. Since the total depreciable book value of any property is the same no matter what depreciation method is used, during the later years of a property's life liberalized depreciation results in lower depreciation charges, and thus higher taxes, than does straight-line depreciation.

Use of accelerated amortization has a similar but more pronounced effect. Under Section 168, to the extent that facilities have been certified as emergency, they may be fully depreciated for federal income tax purposes over a period of five years. Thus, during the first five years of their life the tax is lower than it would be on a straight-line depreciation basis. Thereafter, however, since there is no remaining depreciation allowable for tax purposes, taxes are higher than they would be on a straight-line depreciation basis.

Pursuant to established practices permitted by the Commission, Panhandle has been including within its operating expenses for rate-making purposes the amount of federal income taxes which it would have paid if it had computed such taxes on the basis of straight-line depreciation. As prescribed by the Commission's accounting regulations

(Orders Nos. 171, 171A and 203, 13 FPC 968 and 1051, 19 FPC 826, amending Uniform System of Accounts for Class A and Class B Natural Gas Companies, 18 CFR § 201, Accounts Nos. 281, 282, 410, 411), the excess of this amount over the taxes actually paid has been placed in credit accounts entitled "Accumulated Deferred Income Taxes."² Until such time as they may be needed to pay income taxes higher than those computed on the basis of straight-line depreciation, the funds reflected in these accounts are used by the company in its operations and may not be paid out in the form of dividends.³

Panhandle contends that the Commission erred in not disregarding the source of these funds in determining a fair rate of return, which, therefore, should have been set at 6.46%, the agreed weighted average cost of its capital secured from outside sources through bonds, preferred stock and equity securities.⁴ As an alternative, Panhandle contends that its minimum permissible rate of return is 6.41% reflecting a return of 5.45% on the deferred tax credit. This 6.41% figure was devised to arrive at the same revenue before federal income taxes (i.e., the same cost to rate-payers) as would result if the company were to raise equivalent funds by the sale of securities according to its existing ratio of bonds, preferred stock and common equity. The difference in net return to the company from these

² Account 281, balance sheet account for "Accumulated deferred income taxes—Accelerated amortization"; 282, similar for liberalized depreciation; 410, income account, "Provision for deferred income taxes"; 411, income account, "Income taxes deferred in prior years—credit."

While the Commission has not designated the balance sheet accounts technically as "reserves", in this brief, for convenience, we shall sometimes refer to them as reserves, since the technical distinction is not relevant to the present question.

³ In this brief, for convenience, we shall refer to this Commission approved method of treating liberalized depreciation and accelerated amortization as "normalization". We shall use the term "flow-through" to refer to the alternative practice of including within federal income tax expense for rate-making purposes only the amount of such taxes actually paid with the use of these benefits. This terminology is in line with general usage.

⁴ The phrase "cost of capital" is here used as including the return allowed on common equity although such return may not be the "cost" under a literal definition of that word.

alternative methods of securing such capital results from the fact that interest costs on debt capital are deductible from taxable income for federal income tax purposes, and since there are no interest costs incident to the use of deferred tax reserves, taxes (which must be allowed ahead of return) are higher on income derived from such funds than they would be on capital which includes conventional interest-paying debt.⁵

In including the deferred tax reserve in Panhandle's capital structure at 1.5%, the Commission adopted the principles and policy which it had set forth in its Opinion No. 342, rendered on March 7, 1961, in *Northern Natural Gas Co.*, 25 FPC 431, concerning liberalized depreciation, and which it had thereafter applied to accelerated amortization in *Kansas Nebraska Natural Gas Co.*, Opinion No. 343, 25 FPC 448.

Since the major basis of the Commission's present order is set forth in Opinion No. 342, we are reprinting the relevant portion of that opinion as an appendix to this brief. In this brief, Opinion No. 342 will be identified by reference to that appendix, and indicated "A.—" ⁶

SUMMARY OF ARGUMENT

I. In establishing a rate of return reflecting an allowance of 1.5% on Panhandle's reserves for deferred federal income taxes, the Commission exercised its judgment on consideration and weighing of all relevant factors, including, on the one hand, the cost-free origin of the deferred tax reserves accumulated out of revenues and, on the other hand, Panhandle's ownership thereof. The prescribed rate of return being clearly sufficient to meet established legal standards for just and reasonable rates, the Court should not disturb the Commission's order.

⁵ At the corporate income tax rate of 52%, to realize \$1 in net return, the company must receive \$2.0833 in revenues.

⁶ Because of the argumentative nature of Panhandle's "Statement of the Case" (Br. pp. 2-5), and the inclusion therein of what we regard as misstatements as to prior Commission actions, we feel compelled specifically to disclaim concurrence with that statement.

Panhandle's alternative claims based on the hypothetical costs of private capital bear no relationship to the facts in this case or to the basic just and reasonable standard for rates under the Natural Gas Act. Sections 167 and 168 of the Internal Revenue Code do not require or authorize the Commission to prescribe rates in excess of a reasonable level. The tax statutes simply give rise to additional facts which, along with all other facts, are to be considered in establishing reasonable rates. *El Paso Natural Gas Co. v. F.P.C.*, 281 F. 2d 576 (CA5), certiorari denied, 366 U.S. 912; *Cities of Lexington et al. v. F.P.C.*, 295 F. 2d 109 (CA4).

The Commission's order is consistent with this Court's decision in *City of Detroit v. F.P.C.*, 97 AppDC 260, 230 F. 2d 810, certiorari denied, 352 U.S. 829, in permitting normalization of federal income taxes paid on the basis of accelerated amortization (and liberalized depreciation) and in not deducting from the company's rate base the assets in which the deferred tax reserves have been invested. The Commission concluded that the "fair rate of return" to which a natural gas company would be entitled under the *City of Detroit* view was such rate of return as would serve as a reasonable incentive for the use of accelerated amortization and liberalized depreciation for federal income tax purposes. The Commission may not prescribe rates higher than reasonably necessary to provide such incentive. *City of Detroit v. F.P.C.*, *supra*, 97 AppDC at 267-268, 230 F. 2d at 817-818. On a weighing of the inherent advantages and disadvantages of using these tax procedures, the Commission concluded that adequate incentive would be provided by a rate of return which reflected 1.5% of the accumulated amount in the deferred tax accounts, in addition to the permissible return on the capital obtained by the company from outside investors. A return of 1.5% on funds acquired without cash cost cannot be held insufficient.

Sections 167 and 168 do not guarantee enhanced profits to taxpayers or prescribe the distribution between taxpayers and their customers of the monetary benefits pro-

vided. The Commission's decision achieves for regulated natural gas companies a result reasonably in accord with that probably obtained in representative unregulated industries.

Reflecting the source and nature of the deferred tax reserves in computing a rate of return is distinguishable, practically and theoretically, from excluding from the rate base the assets in which the reserves are reflected. The Commission's approach provides desirable administrative flexibility for the proper continuing adjustment of consumer and investor interests in conformity with both the regulatory and tax statutes.

To the extent that the Court's opinion in *City of Detroit* may be read as indicating that a natural gas company is legally entitled to the maximum theoretically possible monetary benefits of accelerated amortization, it should be reexamined and the Court should reaffirm the rule that the Natural Gas Act still prescribes a just and reasonable standard as a ceiling on natural gas rates.

Panhandle has not met its burden of showing that the order is unjust in its effect. On the contrary, Panhandle's view would result in unreasonable and unjust rates. Acceptance of Panhandle's argument would distort congressional intention by providing maximum benefits to those companies which have least need therefor, i.e., those companies which can readily raise capital at reasonable cost.

It may be that the public interest would be better served if companies not in need of tax assistance for raising capital were to use straight-line depreciation for all purposes. On the other hand, in some circumstances, it might be an abuse of managerial discretion not to use accelerated amortization and liberalized depreciation for tax purposes with resultant savings in cost of service, including cost of capital. However, no such decision was made in this case.

On its face, the present decision clearly shows that the Commission's choice among permissible alternative solutions was reasonably arrived at and is within the permissible range of administrative discretion under both the Natural Gas Act and the Internal Revenue Code.

II. Opinion No. 264, *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 FPC 369; *Amere Gas Utilities Co.*, 15 FPC 760; *Panhandle Eastern Pipeline Co.*, 13 FPC 53; and *City of Detroit v. F.P.C.*, *supra*, 97 AppDC 260, did not involve or decide the question what rate of return, if any, would be permitted on deferred tax credits which might be accumulated pursuant to the Commission-approved tax normalization procedures. None of these actions, therefore, could constitute an estoppel as to that issue.

Panhandle's claim of estoppel is untenable for the reasons, *inter alia*, that: (1) Panhandle has not established any detrimental reliance on Commission action; (2) Estoppel cannot be invoked against the Government, particularly as to general administrative policies such as that here involved; (3) An administrative agency may validly change or reverse its policies and rulings, even with retroactive effect.

There can be no estoppel by judgment because, *inter alia*: (1) There has been no adversary litigation of the issue between the parties; (2) There has been no reviewable decision of the issue involved; (3) *Res judicata* and related doctrines are inapplicable to administrative actions; (4) A decision of an issue even in adversary litigation is not necessarily and for all time conclusive in subsequent litigation between the parties.

The doctrine of *stare decisis* does not prevent an administrative agency's adopting new rules and policies. The Commission must continually reexamine its policies in the light of changing facts and accumulated knowledge and experience.

ARGUMENT

I

PANHANDLE HAS NOT SHOWN THAT A 6.25% RATE OF RETURN IS IMPROPER

A. The Commission-Established Rate of Return Satisfied the Standards of the Natural Gas Act

The facts in this rate case are undisputed. The parties agree that Panhandle's allowable rate of return is properly determinable by traditional standards, in which the "cost of capital," including a return on common equity capital, is a major determinant. There is no disagreement as to the amounts of long term debt, preferred stock and common stock which Panhandle has outstanding, or as to their weighted average "cost"—6.46% per annum.⁷ In addition to \$257,927,825 of capital representing preferred and common stock and debt, Panhandle has capital of \$11,076,954 in accumulated deferred federal income tax accounts, which it accumulated out of revenues up to May 31, 1960, as a result of its use of accelerated amortization and liberalized depreciation for federal income tax purposes. These reserves represent the difference between the federal income taxes which the company has actually paid, using liberalized depreciation and accelerated amortization under Sections 167 and 168 of the Internal Revenue Code, and the higher amount of taxes it would have paid had it computed its depreciation for tax purposes on the straight-line basis, and which it is allowed as an operating expense recoverable through rates. They were accumulated pursuant to accounting procedures authorized by the Commission for regulated companies which use accelerated amortization and liberalized depreciation for income tax purposes. *Amere Gas Utilities Co.*, 15 FPC 760, review dismissed *sub nom. Cities of Lexington, et al. v. F.P.C.*, CADC No. 13590,

⁷ Panhandle originally claimed an overall cost of 7%, based on a return of 11.76% on common equity capital. In the present case, however, it does not contest the Commission's reduction of this latter figure to 10.47%, with resultant lowering of the overall cost of outside capital to 6.46% (Br., pp. 4-5, 17 n. 11).

June 26, 1957; *Treatment of Federal Income Taxes as Affected by Amortization*, Opinion No. 264, 12 FPC 369.

Under the Commission's rules, in determining operating expenses for rate purposes, federal income taxes may be computed as if paid on the basis of straight-line depreciation even though they are actually being paid on the basis of rapid depreciation. The Commission accounting requirement (18 CFR § 201, Accts. Nos. 281, 282, 410, 411) is that if the company for rate purposes claims an allowance for taxes based on straight-line depreciation while actually paying the taxes on a rapid-depreciation basis, the excess of such straight-line tax amounts over the lower amounts actually paid during the early years of the life of the property must be set up in a special credit account to be available to meet the excess of actual over normalized (straight-line-depreciation) taxes in the later years of the property's life.

The Commission's allowance of normalized income taxes as operating expenses for rate-making purposes has been upheld by the courts. *Panhandle Eastern Pipe Line Co.*, Opinion No. 269, 13 FPC 53, affirmed as to this issue *sub nom. City of Detroit v. F.P.C.*, 97 AppDC 260, 230 F. 2d 810, certiorari denied *sub nom. Panhandle Eastern Pipe Line Co. v. City of Detroit*, 352 U.S. 829; *El Paso Natural Gas Co.*, Opinion Nos. 326 and 326A, 22 FPC 260 and 659, affirmed as to this issue, *El Paso Natural Gas Co. v. F.P.C.*, 281 F. 2d 567 (CA5), certiorari denied *sub nom. California v. F.P.C.*, 366 U.S. 912; *United Fuel Gas Co.*, Opinion Nos. 334 & 334A, 23 FPC 127, modified, 23 FPC 512, affirmed as to this issue *sub nom. Cities of Lexington et al. v. F.P.C.*, 295 F. 2d 109 (CA4).

On the basis of the undisputed amount and cost of Panhandle's debt, preferred stock and common stock and the similarly undisputed amount, source and purpose of the deferred tax reserves, the Commission established a rate of return of 6.25% for use in determining reasonable rates for Panhandle under Section 4(e) of the Natural Gas Act. This figure covers the usual allowance for Panhandle's conventional capital, plus an allowance of 1.5% on the deferred tax reserves (R. 3551). The Commission took account of

the fact that, on the one hand, the deferred tax reserves arose out of operating revenues and were not received from outside investors, and, on the other hand, that the company "owns" the funds and is subject to the deferred tax liability. The Commission thus recognized that the funds were acquired without any cash cost to the company, although their use in company operations might entail some small degree of risk. The Commission further analyzed several indirect, not precisely calculable, benefits accruing to the company from the availability of these cost-free funds. It also compared the effects of use and non-use of the available tax benefits from the points of view of both the company and the ratepayers. On a weighing of those multifarious factors, most of them imprecise and intangible, the Commission reached its judgment as to a proper overall rate of return (A. 42-53).

Since that rate of return will permit the company to realize its established cost of debt and preferred stock and a reasonable return on common equity, plus a cushion equivalent to 1.5% on the deferred tax reserves then in existence, it will clearly provide the legal requirement of "enough revenue not only for operating expenses but also for the capital costs of the business" and a return "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 603. In this posture, the order must be sustained because Panhandle has not met "the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." *Ibid.*, p. 602.

Absent a showing by Panhandle that the Commission's rate-making method constituted a "most basic form of abuse", its order may not be disturbed on review. *Battle Creek Gas Co. v. F.P.C.*, 108 AppDC 209, 213, 281 F. 2d 42, 46, quoted in *Ohio Fuel Gas Co. v. F.P.C.*, ... AppDC, ... F. 2d (No. 16112, decided November 9, 1961).

**B. Panhandle's Formulae, Based on Non-existent Facts,
Contravene the Natural Gas Act**

Examination of Panhandle's position readily discloses that it has presented no basis, either in fact or in law, for disturbing the order under review.

Without even a nod to the Natural Gas Act's standard of "just and reasonable" rates, Panhandle contends that deferred tax reserves should be ignored in computing a proper rate of return, but that the assets in which the reserves are invested should be included in the rate base on which it is allowed a return. Adoption of this view would result in the ratepayers' being charged \$1,490,831 for Panhandle's use of cost-free funds generated by the use of liberalized depreciation and accelerated amortization for income tax purposes. This dollar figure represents \$715,600 (6.46% on the reserves accumulated to date), which Panhandle claims as the net return to which it is entitled, plus income taxes payable thereon (computed at 108.33% of the net return). As an alternative, Panhandle suggests (Br., pp. 26-28, 30-31) that its overall rate of return be established at 6.41%, which would cost the ratepayers \$1,258,100, including tax—the same capital cost as they would be required to meet if the company were to raise an equivalent amount from outside sources in its present proportions of debt and preferred and common stock.

Panhandle thus claims as a return on these funds the same net income after taxes, or at least the same gross revenue, as it assumes it would have realized if it had resorted to outside sources to raise this capital. It would thus measure its return by reference to a hypothetical, nonexistent factual situation. Both its alternatives ignore the brute fact that the company does have these funds accumulated out of revenues and thus will not incur the hypothetical capital costs by which it seeks to measure its return. Panhandle has advanced no public interest justification for requiring ratepayers to shoulder costs which the company has been spared by the ratepayers' having provided the company with funds for the payment of income taxes before the taxes were due. Neither the hypothetical

monetary return to the company nor the hypothetical maximum cost to the ratepayers on a nonexistent set of facts can reasonably be used as a basis for determining reasonable rates, which must be so established as to allow the company neither more nor less than a "fair rate of return" on its invested capital.

In purported justification of rates so grossly in excess of a reasonable level relative to its costs, Panhandle advances only a contention that Congress intended Sections 167 and 168 of the Internal Revenue Code to benefit taxpayers, including regulated utilities. From that statement, with which we have no quarrel, Panhandle leaps to the conclusion that the Commission must forego any examination of the actual facts and eliminate all considerations of reasonableness of rates in order to enable Panhandle to realize the maximum theoretical monetary benefit of the tax laws and to prevent ratepayers from securing any advantage whatsoever from their prepayment of Panhandle's federal income taxes.

There is not a word in the text or legislative history of Sections 167 or 168 of the Internal Revenue Code which would support any such view. These provisions do not supersede the Natural Gas Act, but simply give rise to new factual situations to which the Commission must apply the statutory standard of "just and reasonable rates."

Definitive decisions establish that the Commission may not validly establish rates in excess of reasonable rates because of a presumed congressional intention underlying tax statutes.

In *Cities of Lexington, et al. v. F.P.C.*, *supra*, 295 F. 2d 109 (CA4), the court sustained the Commission's decision that the benefits realized through other provisions of the Internal Revenue Code concerning percentage depletion and intangible well-drilling costs (which provisions are not involved in the present case) constitute tax savings rather than mere deferrals and therefore taxes paid under such provisions should not be normalized in computing operating expenses in rate determinations under the Natural Gas Act. The court then rejected a dictum in the

Commission's decision to the effect that a natural gas company would be entitled to realize the full amount of the potential benefit of these provisions even if such treatment resulted in rates higher than reasonable rates as computed under the standards of the Natural Gas Act. In this connection, Judge Soper, for the court, said (295 F. 2d at 116, 117-118):

We find nothing in the Natural Gas Act which requires the Commission to ignore the usual principles of cost accounting and set up a fictitious and unreal tax expense on the part of the utility in order to give it the entire benefit of the tax saving statute and none to the consuming public. The very spirit and purpose of the regulatory provisions of the Natural Gas Act point the other way. * * *

* * * the Commission, in our opinion, was in error since it focused its attention upon the tax statutes and lost sight of the broad responsibility imposed upon it by the Natural Gas Act, for it indicated that in a certain contingency it would be obliged by the tax statutes to give to the utility a greater return than the just and reasonable return to which the utility is restricted by the regulatory act.^[8]

The court proceeded to observe that "the Commission is bound to take into account the effect of tax benefits provided by the statutes," but emphasized that (p. 118):

* * * The prime duty of the Commission in this and in all other cases is to fix a fair and reasonable rate after all of these matters have been taken into account.

In support of its decision, the Fourth Circuit cited the decision and rationale of the Court of Appeals for the Fifth Circuit in *El Paso Natural Gas Co. v. F.P.C.*, *supra*, which, *inter alia*, sustained the Commission's normalization of the income tax benefits of liberalized depreciation and

⁸ Cf. *Carpenters' Union v. N.L.R.B.*, 357 U.S. 93, 110: " * * * nor should a determination under one statute be mechanically carried over in the interpretation of another statute involving significantly different considerations and legislative purposes. * * * "

its refusal to normalize taxes reduced by the use of statutory depletion deductions and expensing of intangible well-drilling costs. In *El Paso* the court pointed out that giving the company the benefit of the tax provisions in question does not require enlarging the content of the statutory standard of just and reasonable rates. Judge Tuttle, while recognizing "that full effect must be given to the Congressional intent to make the several tax savings available to this taxpayer," there said (281 F. 2d at 571-572):

• • • [T]his does not mean that these tax benefits are to be translated into additional profits for the regulated company over and above a reasonable return on its investment. They are available to the regulated companies to make it so much the easier for them, in competition with other fuels and in competition with other industries seeking the investor's dollar to earn a fair return, *including* the substantial increment of incentive for exploration and development and payment for gas consumed.

• • • [T]here is nothing in the legislative history that would warrant our concluding that Congress intended the statutory depletion, deduction of intangible drilling expense, and rapid depreciation provisions of the Revenue laws to amend or modify the express language of the Natural Gas Act • • •

If, on the record in this case, the Commission had allowed Panhandle the 6.46% return on funds acquired without cash cost, the Commission might well have run afoul of this Court's unequivocal admonition in *City of Detroit v. F.P.C.*, *supra*. In that case, in order to encourage pipeline development and ownership of productive property, the Commission had used field prices of gas in establishing Panhandle's rates. In striking down that Commission action, this Court said (97 AppDC at 267-268, 230 F. 2d at 817-818):

• • • If the Commission contemplates increasing rates for the purpose of encouraging exploration and development, or the ownership by pipeline companies of their own producing facilities, *it must see to it that*

the increase is in fact needed, and is no more than is needed, for the purpose. . . .

The amount allowed Panhandle for the encouragement referred to is not shown to meet this test by any evidence and findings. Of course, the rate increase attributable to producing properties might have a tendency to encourage their ownership, and perhaps also the development of new sources of production, as an even greater increase also might do. But the question is whether a lesser amount would suffice. The amount here allowed is not brought into relationship by the evidence and findings with the purposes for which it is granted except that it affords a larger revenue to Panhandle than otherwise it would have. . . . [Emphasis supplied; footnotes omitted.]

Similarly, in the present case, Panhandle has made no showing that the return it requests on its deferred tax reserves is the minimum necessary to effectuate the claimed congressional intention or to achieve any other proper purpose. So far as is shown by Panhandle's argument, the only purpose which adoption of its view would serve would be to afford "a larger revenue to Panhandle than otherwise it would have."

Panhandle ignores this Court's reminder that (97 App DC at 265, 230 F. 2d at 815):

. . . it remains true that the primary aim of the [Natural Gas] Act, in the words of the Supreme Court, is "to protect consumers against exploitation at the hands of natural gas companies." Federal Power Commission v. Hope Natural Gas Co., 320 U.S. at page 610 . . .

C. The Commission's Decision is Consistent With City of Detroit v. F.P.C.

Panhandle relies practically exclusively on certain language in *City of Detroit v. F.P.C.*, *supra*, to reach a conclusion not warranted by the decision of the issue actually presented in that case. There the Court adopted Panhandle's and the Commission's view that the use of accelerated amortization under Section 168 of the Internal Revenue Code might be viewed as granting a deferral rather

than a permanent saving or reduction of taxes. On this basis the Court approved the Commission's holding that *in determining operating costs* for rate-making purposes federal income tax expense could be computed on the conventional straight-line depreciation basis, with the deferred portion of the taxes credited to a special credit account, to be later charged for "over-normal" tax payments when taxes become higher than they would be by the use of straight-line depreciation. The Court further declared that since in the meantime the deferred tax funds belonged to the company and were being used in the company's operations, they should not be deducted from the rate base but should be included within the income-producing property on which the company was entitled to a "fair rate of return."

In rejecting the consumers' objections to this treatment, the Court properly observed that the accelerated amortization provision of Section 168 of the Internal Revenue Code (230 F. 2d at 822):

• • • unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. • • •

But it does violence to elementary logic to say, as Panhandle argues, that statutes designed for consumer benefit must be ignored, or even affirmatively violated, in order to prevent consumers' realizing any ultimate benefit from a general tax statute.

The fact is that Sections 167 and 168 were intended generally to foster industrial growth and expansion, with no specific legislative attention directed to any conflict, real or apparent, between taxpayers and their customers. Sections 167 and 168 do not prescribe or limit the taxpayers' use or disposition of the benefits accruing therefrom. So far as the statute is concerned, an unregulated taxpayer may distribute all the benefits to its stockholders in the form of dividends. On the other hand, it may pass on all the benefits to its customers in the form of price reductions, perhaps in the hope that such action will improve the company's competitive position and increase sales. See *e.g.*,

City of Pittsburgh v. Pennsylvania P.U.C., 182 Pa. Superior Ct. 551, 128 A. 2d 372, 382-383, allocatur refused; *City of Alton v. Illinois Commerce Commission*, 19 Ill. 2d 76, 165 N.E. 2d 513, 521; *Public Service Co. of New Hampshire v. State*, 102 N.H. 150, 153 A. 2d 801, 805; *Cincinnati Gas & E. Co.*, 35 PUR 3d 392, 398 (Ohio); *Empire District Electric Co.*, 23 PUR 3d 50, 52 (Kan.). In the *Alton* case the court observed that Congress had not prohibited a taxpayer from passing on to its customers some or all of the benefits of liberalized depreciation "and it may be supposed that many corporations have done so under the pressure of competition." And in *Empire*, the Kansas State Corporation Commission said it was

* * * quite sure that industries which are in competitive fields can be expected to pass on to the consumers of their products, by way of lower prices, by improved products, or in other ways a fair share of the benefits they will derive from accelerated depreciation. * * *

In short, while Congress intended Section 168 (and the same is true of Section 167) of the Internal Revenue Code as a benefit to industry, it did not prescribe the use or distribution of such benefit. In these provisions Congress did nothing to control or restrict the play of competitive forces and it appears to be a matter of plain common sense that in a financially sound unregulated industry, price levels would necessarily reflect the availability of substantial amounts of cost-free capital.

While general provisions of law such as Sections 167 and 168 may have different impacts on regulated and unregulated industries, it is, nevertheless, probably a truism that—

In a broad sense, the objective of public utility rate regulation is to achieve through regulation the same result that would be achieved by competition. * * *
[Clemens, *Economics and Public Utilities* (1950), p. 153.]

The Supreme Court of Indiana has expressed this thought simply, saying that utility regulation "is designed to sup-

ply the missing element of competition which protects the public from excessive charges in competitive business." *P.S.C. v. Indiana Bell Tel. Co.*, 235 Ind. 1, 130 N.E. 2d 467, 481.

It certainly cannot be seriously contended that Congress intended by Sections 167 and 168 of the Internal Revenue Code to guarantee benefits to regulated utilities which it did not guarantee to non-regulated industries and which it is unlikely that many unregulated industries could obtain in the face of free competitive forces. On the contrary, it is clear that regulated utilities were only incidental beneficiaries of statutory provisions designed to aid industry generally, which, primarily because of the hazards of competitive forces, was often unable readily to secure capital for expansion.

If anything, the relatively lower risk enjoyed by utilities would warrant less, rather than more, assurance of tax benefits to them than to unregulated industries. As Judge Soper pointed out in *Cities of Lexington, et al. v. F.P.C.*, *supra*, in connection with other statutory tax benefits (percentage depletion and intangible well-drilling costs; 295 F. 2d at 116):

• • • It cannot be supposed that it was the duty of the Commission to consider these unusual concessions in the tax statutes as devices for the benefit of the producer without regard to the interest of the consuming public whose outlay furnishes the support on which the industry depends. It must be kept in mind that we are not dealing with an enterprise which itself takes all the risks, but with a regulated industry with an assured demand for its product which is protected by the requirement that in fixing the rates all elements of cost must be considered which pertain to the original investment, the depletion of capital assets, the cost of operation and the costs of exploration.

Cf. City of Pittsburgh v. Pennsylvania P.U.C., *supra*, 128 A. 2d at 382-383.

This is not to deny that utilities, along with unregulated industries, are entitled to use accelerated amortization and liberalized depreciation for federal income tax purposes.

But the fact of regulation in the public interest must be taken into account in determining the effect of these tax procedures on utilities, just as the fact of competition substantially determines the effect of tax benefits on unregulated industry.

The fact is that in utility regulation, as in unregulated competitive industry, conflicts of interest between buyer and seller can be and usually are adjusted with benefit to both sides. It may be said that a proper adjustment of such interests accords to the selling utility what is, by definition, a "fair rate of return."

The Commission has not deducted the amount of the deferred tax reserves from the rate base, as it was urged to do by some consumer interests, but instead has considered the issue from the point of view of determining a reasonable rate of return. This approach looks at both sides of the coin; it takes account of all assets in the rate base as well as of the fact that some of these physical assets were purchased with funds acquired by the company without cost.

It is true, as Panhandle indicates (Br., p. 16) and as the Commission acknowledged in its *Northern* opinion (A. 49), that substantially the same practical effect could be achieved by deducting the reserves from the rate base as by including them in the capital structure at a cost of zero. But, where, as in the present case, the Commission allows some return on them, there are important theoretical and practical differences between the two courses.

The Kansas State Corporation Commission has well articulated the relevant considerations in *Empire District Electric Co., supra*. In rejecting the suggestion that the deferred tax reserves be deducted from the rate base, that commission said (23 PUR 3d at 52-53):

(1) It fails to recognize risks assumed by the stockholders of a utility when such utility elects to use accelerated depreciation. * * * It implies that the ratepayer is the only one entitled to the direct benefits from the use of accelerated depreciation, and that the risks should be assumed by the stockholders with little or no prospect of compensation therefor. The commission

considered that one alternative to this method could be to make allowance for such risks by deducting only a portion of the tax deferral reserve from the rate base.⁹ This alternative would require a review of such risks at each time of a rate review and would call for a judgment on part of the commission in the determination of the portion to be deducted. In the commission's opinion, judgment factors more properly belong in the determination of the rate of return.

(2) * * * We could see justification in the deduction if such amount represented capital contributed by the utility users, but this is not the case.

* * * In other words, the use of accelerated depreciation will produce some interest-free capital which will reduce the overall cost of the money necessary to support Empire's rate structure. * * * If through a continuation of plant expansion, a reduction in income tax rates, or by other reason, the tax deferral reserve continues to grow, the cost of capital will be further reduced and there will be opportunity to allow greater benefits to be passed on to consumers in the rates of return granted. On the contrary, if by recession in plant expansion, by increases in future tax rates or by repeal or alteration by Congress of accelerated depreciation provisions, the tax deferral reserve is then found to be decreasing, the rates of return will require appropriate adjustment in light of the circumstances.

Other state commissions have similarly reflected the cost-free nature of the funds in the rate of return. See, e.g., *Washington Water Power Co.*, 33 PUR 3d 88, 94 (Idaho); *Washington P.S.C. v. Washington Water Power Co.*, 33 PUR 3d 468, 475, 490, 492 (Wash.).¹⁰

Taking account of the origin of these funds in computing the utility's rate of return provides a flexibility which facilitates a proper "balancing of investor and consumer interests." *City of Detroit v. F.P.C.*, *supra*, 230 F. 2d at 816. Perhaps its greatest virtue lies in permitting those differences "in degree" which Panhandle apparently finds

⁹ The Florida commission has deducted 50% of the annual deferred tax accruals from the rate base. *Inter-County Tel. & Tel. Co.*, 33 PUR 3d 287, 291.

¹⁰ There are, of course, other alternatives available. For example, interest on the reserves may be credited to income. See e.g., *Tax Treatment of Accelerated Depreciation*, 57 Cal. PUC 598, 33 PUR 3d 209, 220.

objectionable (Br., p. 16). See Statement of Chairman Krueger of the Ohio commission at a panel discussion, NARUC 70th Ann. Conv., 413, 419.¹¹

It is analytically sound in recognizing that while the funds were acquired without cost, the company may be subject to the risks of future liability for the "deferred" income taxes. This approach avoids saddling ratepayers with the hypothetical cost of private capital while enabling the Commission to make an allowance appropriate to any limited risk which might be incurred.

The Commission's present decision is thus entirely consistent with the Court's decision in *City of Detroit*. The reserves have not been deducted from the rate base, but remain as part of "the valuations upon which [Panhandle] is entitled to earn a fair rate of return". *City of Detroit v. F.P.C.*, *supra*, 97 AppDC at 272, 230 F. 2d at 822.

Moreover, the issue now presented is one not reached in *City of Detroit*, namely, what is a fair rate of return on invested capital which includes accumulated deferred tax reserves? The Court's opinion, therefore, was not guided by attention to that issue. The phrase "fair rate of return" was left unexamined and undefined. The breadth of some of the Court's language must be assumed to have resulted from the parties' and the Court's failure fully to anticipate the issue of the present case and thus fully to appreciate the potential future ramifications of the tax normalization treatment approved in *City of Detroit*.¹²

¹¹ At the time of this discussion, Ohio followed the reserve-normalization method. *Ohio Fuel Gas Co.*, 25 PUR 3d 207. It has since changed to the flow-through principle (i.e., allowing only actual taxes as an operating expense), with Commissioner Krueger dissenting. *Ohio Water Service Co.*, 35 PUR 3d 385, 391; *Cincinnati Gas & Electric Co.*, 35 PUR 3d 392, 402.

The other participants in the NARUC panel discussion were Commissioners McMahon of Maine and Padrutt of Wisconsin, the former espousing the flow-through theory, the latter contending that the deferred taxes should be added to depreciation reserves, which would result in their being deducted from the rate base.

¹² The Court's apparent acceptance in footnote 17 to its opinion (97 AppDC at 272, 230 F. 2d at 822) of Panhandle's tacit assumption that it would be entitled to its "full" rate of return on such cost-free funds is difficult to reconcile with its view that the treatment of the tax issue "does not result in higher rates to the consumer" (*ibid.*). This is recognized in Panhandle's alternative request in the present case.

We respectfully submit that, while the decision in *City of Detroit* was sound, the opinion should be reexamined with a view to recognition of the basically dynamic and fluid effect of accelerated amortization and liberalized depreciation. *City of Detroit* was decided in the early days of the accelerated amortization program, with its five year writeoff of emergency facilities. Underlying the decision was the view that accelerated amortization resulted only in tax deferrals and that the company would use the accumulated reserves to meet the deferred taxes. When the *City of Detroit* decision was rendered, it was reasonable to assume that the deferred income taxes would actually become due in the relatively near future. Since then, however, with the addition of liberalized depreciation, the scope and duration of tax deferments have been enlarged. As a company acquires new depreciable assets, the tax reserves continue to increase, and the potential future tax liability is further deferred. The benefit from the funds is thus enhanced, as the risk declines.¹³ And the "risk" factor is the only element of potential "cost" associated with these funds. A rate of return which allowed for other costs, not experienced, would be in conflict with the purposes and provisions of the Natural Gas Act.

We believe the Court should now clarify, or, if necessary, limit its opinion in *City of Detroit*, so as to negate the view that deferred tax reserves must be entirely disregarded in computing a fair rate of return or that a rate of return may be measured solely by the fictitious or hypothetical costs of capital which might be incurred if the company

¹³ See *City of Alton v. Illinois Commerce Commission*, *supra*, 165 N.E. 2d at 521-522: "If we could see clearly into the future and say with certainty that continuing expansion was certain, and countervailing considerations were nonexistent, we would hold that the Commission may not permit current charges for a liability that will never arise. . . . At this time, we think it permissible for the Commission to safeguard the financial integrity of utilities by recognizing as present expenses those tax liabilities which are deferred by use of accelerated depreciation for Federal tax purposes." The court there required that the reserves be deducted from the rate base. See also, *Gulf Power Co.*, 10 PUB 3d 273, 275 (Fla.): ". . . if it should subsequently develop that the utilities have enjoyed a tax reduction rather than a tax deferral, the commission can take a second look at the matter, both in the interest of the utilities and its ratepayers."

were to raise capital from outside sources. The Court should make it clear that the law does not prohibit regulatory action which would allow ratepayers to participate in the benefit from a utility's use of accelerated amortization and liberalized depreciation for federal income tax purposes. As the Fourth and Fifth Circuits have done in *Cities of Lexington* and *El Paso*, this Court should reaffirm the principle that the "just and reasonable" standard of the Natural Gas Act prescribes a ceiling on rates which cannot be pierced to provide gratuities for regulated companies on the basis of an unexpressed extension of a tax statute.

D. Panhandle Has Not Shown That the Decision Contravenes the Provisions or Spirit of Either the Internal Revenue Code or the Natural Gas Act

Heeding both the congressional purpose in Sections 167 and 168 of the Internal Revenue Code to make capital available for industrial expansion and the basic purpose of the Natural Gas Act to maintain rates at a reasonable level, the Commission here undertook to establish rates in a manner which would encourage regulated companies to avail themselves of the tax benefits with resultant mutual advantage to their investors and their ratepayers.¹⁴

Panhandle's attempted attack (Br., pp. 22-26) on the Commission's judgment that a cushion of 1.5% per annum on deferred tax reserves constitutes a reasonable incentive for the continued use of liberalized depreciation is as unsupported as is its affirmative claim to a rate of return computed with reference to non-existent, hypothetical costs of capital.

Since, as the Commission stated, the propriety of any rate of return is, in the last analysis, a matter of judgment, calling for the application of accumulated experience and

¹⁴ Some authorities have held that utilities may be required to use liberalized depreciation. *Bangor Hydro-Electric Co.*, 26 PUR 3d 489 (Me.); *Consumers Power Co.*, 29 PUR 3d 133 (Mich.), dissenting opinion, p. 152; Ben W. Lewis, *The Duty of a Public Utility to Reduce Its Income Tax Liability by Using Accelerated Depreciation*, 35 *Land Economics* 104.

administrative expertise to particular situations, it may be conceded that the Commission might properly have taken a different approach to the problem and reached some other conclusion. There has been a wide variety of decision among the many other regulatory agencies, both state and federal, which have passed on the accounting and rate-making treatment to be accorded the use by utilities of accelerated amortization and liberalized depreciation for income tax purposes. See, e.g., Report of the Special Committee on Tax Amortization of the Federal Power Bar Association, April 20, 1961, Appendices A and B; Max Swiren, *Accelerated Depreciation Tax Benefits in Utility Rate Making*, 28 U. of Chi. L.R. 629, App. pp. 625-662.

In arriving at its choice among an almost limitless number of possibilities, the Commission in its *Northern* opinion started with a recognition of the many intangible, though nonetheless very real, benefits to the company and its investors inherent in the use of accelerated amortization and liberalized depreciation. It summarized some of these indirect benefits to the company as follows (A. 53):

Apart from earnings, the use of deferred taxes to supply a portion of the company's capital requirements has certain material advantages. The substantial sums involved are readily available without resort to the market, and such additions to capital serve to reduce the company's debt ratio. The acquisition of plant by use of deferred taxes provides additional security not subject to lien on which new loans can be based, perhaps at lower interest rates than would otherwise be possible. Furthermore, deferred tax funds accumulated between rate cases and invested in plant may, during that period, increase the company's earnings. Finally, the accumulation of deferred taxes increases the company's funds available for expansion without issuing additional common stock. It thus gives the existing stockholders the entire benefit of any earnings from the new investment. • • •

But the Commission also recognized, as this Court had observed in *City of Detroit v. F.P.C.*, *supra*, 97 AppDC at 272, 230 F. 2d at 822 n. 17, that to some extent the inherent

benefits "might be too easily offset by disadvantages" to afford the companies adequate incentive to use the tax statutes as they were intended. It decided, therefore, that at this time some supplementary benefit should be provided in the form of direct monetary gain.

Since the inherent benefits of the tax law provisions are not amenable to precise monetary valuation, the monetary supplement reasonably adequate to induce use of the statutory provisions cannot be calculated on a slide rule. The Commission did, however, show that various mathematical computations tended to support its conclusion (A. 50-51). Its computations show that permitting a return of 1.5% on the deferred tax reserves results in a substantial cost saving to consumers with only an insignificant reduction in net return to the company as compared with the possible alternative methods of raising equivalent funds in the market. The Commission's exhibit (A. 52) shows that it would cost ratepayers some \$1,028,000 for a company with a representative capital structure to raise \$10,000,000, with a net return to the company after taxes of \$300,000. In contrast, if the company used the cost-free deferred tax reserves, the consumers' cost of a 1.5% return thereon would be some \$312,000 and the company's net return would be \$150,000. The difference between the two methods amounts to \$716,000 to the consumers, but only \$150,000 to the company. And the Commission further observed that the net annual cost to the ratepayers would be only \$200,020 if the funds were raised by the issuance of 5% bonds (A. 48). While one cannot assume that the company would raise this sum as senior debt, the computation is useful in arriving at an ultimate judgment as to a proper overall rate of return on capital which includes substantial cost-free funds. The Commission noted that if the company were to raise the funds by long-term debt, the net return to common stockholders from such borrowed capital would range from 1.25% to 1.75% (A. 51). Allowing a return of 1.5% on the reserves would thus provide existing stockholders approximately the same return, without either

further thinning the capital or further subordinating their equity.

Panhandle has adduced neither evidence nor argument to meet its "heavy burden of making a convincing showing that [the order] is invalid because it is unjust and unreasonable in its consequences" (*F.P.C. v. Hope Natural Gas Co.*, *supra.*, 320 U.S. at 602). Indeed, the closest it comes to an attempted justification of its attack on the Commission's decision is the anomalous argument (Br., p. 25) that because Panhandle is "one of the strongest of the major pipelines," ratepayers should be required to provide it a greater rate of return on cost-free funds than should the ratepayers of weaker companies. It is, to say the least, a novel theory which would result in increasing the rate of return as the financial strength and stability of a company increase, as though its costs of capital were higher instead of lower. While insisting on congressional intention to assist companies in securing funds for expansion, Panhandle simultaneously argues, in effect, that it should receive maximum possible benefits for the very reason that it claims to have little or no need for the assistance provided by Congress.

At this time the Commission has established and announced its general policy of computing rates for natural gas companies which use accelerated amortization and liberalized depreciation in paying their federal income taxes. It has not as yet been called upon to decide whether a company's refusal to use available tax benefits might constitute an abuse of managerial discretion resulting in unreasonable rates. Whatever decision might eventually be made on that question, it cannot be said as a matter of law that ratepayers must be compelled to provide returns beyond a company's needs simply because the company might have raised funds at greater cost without tax assistance.

If ratepayers are to be required to pay the equivalent of the costs of raising private capital regardless of whether the company needs and uses tax assistance, the public interest would undoubtedly be better served by the company's

using straight-line depreciation for all purposes. In that way the company would secure necessary capital and be compensated for the costs thereof, while the public treasury would be spared the cost of the tax deferment. And the expansion or modernization which Congress sought to foster would not be impeded.

The Commission's policy here accords Sections 167 and 168 of the Internal Revenue Code the effect of permitting companies temporarily to use funds which otherwise would be immediately payable to the Government. So long as they are enabled to use such capital without detriment, it certainly cannot be said that they have been denied a fair return on invested capital.

Panhandle's disingenuous contention that the Commission's decision is "unsupported by findings or evidence" (Br., p. 25) cannot obscure the absence of any demonstration by Panhandle that the rate of return prescribed by the Commission "is unjust and unreasonable in its consequences". *F.P.C. v. Hope Natural Gas Co.*, *supra*, 320 U.S. at 602. In *N.L.R.B. v. Seven-Up Co.*, 344 U.S. 344, the Court rejected a contention similar to Panhandle's, Mr. Justice Frankfurter saying (p. 349):

* * * in devising a remedy the Board is not confined to the record of a particular proceeding. "Cumulative experience" begets understanding and insight by which judgments not objectively demonstrable are validated or qualified or invalidated. The constant process of trial and error, on a wider and fuller scale than a single adversary litigation permits, differentiates perhaps more than anything else the administrative from the judicial process. * * *

In the present situation, the Commission reasonably addressed itself to a problem which uniquely called for "pragmatic adjustments." *F.P.C. v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586. As said in *Cities of Lexington, et al. v. F.P.C.*, *supra*, (295 F. 2d at 114):

It is obvious that we are confronted in this case with a problem in a special field which requires the exercise of expert skill that has been generally entrusted by

state and Federal legislation to administrative regulatory tribunals whose decisions, in the absence of abuse of discretion, should be followed by the courts. We adopt that course in this case. * * *

Judicial review is at an end when it appears, as it does on the face of the Commission's opinion in this case, that the administrative agency has actually exercised its discretion and reached a considered judgment. The decision is not rendered vulnerable by the fact that the Commission might have, with perhaps equal soundness, reached a different conclusion, or that the reviewing court might have devised a different solution if the matter had been within its initial jurisdiction. *S.E.C. v. Chenery Corp.*, 332 U.S. 194, 207-209; *American Power and Light Co. v. S.E.C.*, 329 U.S. 90, 118. The Commission "was created for the purpose of using its judgment and its knowledge" (*Chicago, Burlington & Quincy R. Co. v. Babcock*, 204 U.S. 585, 598, quoted in *N.L.R.B. v. Seven-Up Co.*, *supra*, 344 U.S. at 348), and it has used its judgment and knowledge in this case.

II

NO PRIOR ADMINISTRATIVE OR JUDICIAL ACTION PRECLUDES THE PRESENT DECISION

A. There is No Basis in Fact or in Law for Invoking an Estoppel Against The Commission

Panhandle apparently attempts (Br., pp. 17-22) to invoke the principles of estoppel *in pais* or by judgment on the basis of the Commission's Opinion No. 264, *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 FPC 369, and its decisions in *Amere Gas Utilities Co.*, 15 FPC 760, rehearing denied, 16 FPC 880, and *Panhandle Eastern Pipe Line Co.*, 13 FPC 53, together with this Court's decision *City of Detroit v. F.P.C.* *supra*, 97 AppDC 260, 230 F. 2d 810, certiorari denied, 352 U.S. 829, sustaining the Commission's *Panhandle* decision so far as accelerated amortization is concerned.

None of the Commission's actions referred to could possibly have the effect claimed by Panhandle, for the reason,

inter alia, that none of those proceedings was concerned with the issue here presented, namely, the effect of deferred tax funds on a fair rate of return.

The earliest ruling cited, Opinion No. 264, resulted from a rule-making proceeding in which the Commission "announc[ed] its policies" (12 FPC at 369) of permitting normalization of benefits accruing from accelerated amortization. The Commission there stated that in individual rate cases as they arose it would allow as operating expenses the amount of income taxes which would result from the use of straight-line depreciation and that the difference between that amount and the lower taxes actually paid should be placed in a special account. To date, the Commission has consistently applied this policy, as it did in the present case, without objection by Panhandle.

In Opinion No. 264, the Commission further said (12 FPC at 373):

* * * we will take all steps necessary to insure that provision is made for meeting the deferred tax liability and the temporary savings produced by the deferral of taxes are *not used, directly or indirectly, for the payment of dividends* * * * [emphasis supplied].

Nobody could reasonably rely on this formulation of policy as even remotely assuring natural gas companies that in future rate cases the Commission would establish rates by reference to non-existent costs so that the companies could realize substantial profits unrestricted as to use and thus available for the payment of dividends to stockholders, who had not provided any of the funds reflected in the reserves.

In the *Panhandle* decision, applying the policies of Opinion No. 264, the Commission held (13 FPC at 82) that "Panhandle should be allowed to *include in its cost of service* the amount of its Federal income taxes computed on the basis of the depreciation reduction related to the service life of the facilities being depreciated." (Emphasis supplied) The rate of return then allowed was based on the company's capital structure in 1952, the test year, when

no reserves for deferred taxes had been accumulated. The Commission's order provided that "Panhandle *shall set up and maintain special accounts*" for deferred taxes (13 FPC at 116, emphasis supplied). It was not until the present filing of increased rates that the Commission had occasion to consider the effect on Panhandle's overall cost of capital of the substantial funds subsequently accumulated pursuant to its 1954 order.

The rate of return on the then existing capital structure was not disputed in the review proceeding in this Court. In sustaining the Commission's treatment of accelerated amortization, therefore, the Court was not called upon to, and did not, decide what would constitute a "fair rate of return" on the capital which would be accumulated in the accounts in the future.

That *City of Detroit (Panhandle)* does not stand for the principle which Panhandle now attributes to it clearly appears from *Amere*, in which, as Panhandle states, it was an active intervening petitioner before the Commission (Br., pp. 4, 18) and an intervening respondent to a petition for review filed in this Court (*Cities of Lexington et al. v. F.P.C.*, CADC No. 13,590, petition dismissed June 26, 1957). *Amere* arose on a petition for a declaratory order filed with the Commission by several natural gas companies. In a decision therein, rendered a year after this Court's decision in *City of Detroit*, the trial examiner adopted the petitioning companies' view that they should be permitted to normalize federal income taxes paid on the basis of liberalized depreciation under Section 167 of the Internal Revenue Code. In his decision, the examiner expressly noted that (15 FPC at 763, 764):

Petitioners do not request a determination as to the ultimate treatment of the reserve for deferred taxes for rate purposes, namely, whether petitioners will be entitled to earn a return on the plant which may be acquired with the funds derived from deferred taxes reflected in the reserve. They frankly admit that when that question arises they will contend that they are entitled to a return on such property, but *they insist that this question is not now before the Commission*

and that its consideration here now would be premature.

* * * * *

The question here presented for ultimate determination is, then, whether the Commission should permit for accounting and rate purposes the treatment of depreciation, and the concomitant treatment and disposition of amounts attributable to Federal income taxes, proposed by the companies in their petition. [Emphasis supplied.]

The Commission affirmed the examiner's decision (15 FPC at 781) and dismissed an application for rehearing (16 FPC 880). This Court then dismissed a petition for review on the ground that the decision constituted merely a statement of Commission policy, which would not be reviewable until it was "effectuated in an order or orders * * * such as an order affecting rates." *Cities of Lexington, et al. v. F.P.C., supra*, CADC No. 13,590, order entered June 26, 1957.

Since it is thus clear that none of the actions on which Panhandle seeks to rely involved or decided the rate of return issue presented in the instant case, it is unnecessary to discuss in detail the legal infirmities in Panhandle's claims of estoppel *in pais* and estoppel by judgment. However, for the sake of completeness, we shall demonstrate as briefly as we can that neither of these doctrines would be applicable even if the cited actions had concerned the present issue.

Panhandle's claim of "detriment" or "injury" resulting from its election to use accelerated amortization and liberalized depreciation is based solely on the conjecture that if it had raised from outside sources the equivalent of its deferred tax reserves, it "could have earned substantially more than 1.5 percent" on the facilities in which such capital funds were invested (Br., p. 18). In so arguing, Panhandle ignores the numerous advantages accruing to it from the use of Sections 167 and 168 of the Internal Revenue Code in addition to allowance of a monetary return on the cost-free funds in future rate proceedings. (See dis-

cussion, *supra*, p. 24.) Not the least of these benefits is the use of funds for income-producing purposes as they accumulate between rate cases. And such returns are not subject to reduction by interest payments and required dividends on preferred stock, as outside capital would be.

In the face of the numerous substantial indirect benefits accruing to the company from the accumulation of reserves out of revenues, the existence or extent of any net detriment is so nebulous and conjectural as to be insufficient to support a claim of promissory estoppel even in purely private litigation. *Cf. e.g., McNamara v. Miller*, 106 AppDC 64, 269 F. 2d 511, 514; *Meredith v. John Deere Plow Co.*, 261 F. 2d 121, 124 (CA8).

More fundamentally, "the fact remains that estoppel may not be used against the Federal Government." *Legerlotz v. Rogers*, 105 AppDC 256, 258 n. 5, 266 F. 2d 457, 459 n. 5. While this generalization, like all others, may be subject to modification or exception in exceptional circumstances,¹⁵ the principle of equitable estoppel cannot be applied to prevent a government agency's maintaining a continuing review of its rules and policies to the end that they shall reflect the agency's best judgment in the light of accumulated knowledge and experience. *Continental Distilling Corp. v. Humphrey*, 95 AppDC 104, 109-110, 220 F. 2d 367, 372; *Shawmut Association v. S.E.C.*, 146 F. 2d 791, 796-797 (CA1). *Cf. F.C.C. v. WOKO, Inc.*, 329 U.S. 223, 228.

The Commission's decisions in *Northern* and in this case are not rendered vulnerable by the fact that the present issue was not anticipated and covered in any prior general ruling. *S.E.C. v. Chenery Corp.*, *supra*, 332 U.S. at 201-202; *American Power Co. v. S.E.C.*, 329 U.S. 90, 106.

¹⁵ *E.g., Vestal v. Commissioner of Internal Revenue*, 80 AppDC 264, 152 F. 2d 132, cited by *Panhandle* (Br., p. 18), where this Court, carefully limiting the decision to the precise facts presented, held that the Commissioner of Internal Revenue, "having made, within the scope of his authority, with full knowledge of all the facts and being fully conscious of the problem involved, an election to collect a tax upon a given transaction upon a stated basis, cannot later be heard to assert another tax upon the same transaction against the same individuals. . . ." (80 AppDC at 268-269.)

The present case concerns increased rates for the future filed by Panhandle. Thus, contrary to Panhandle's view (Br., p. 18), the Commission's decision is not "retroactive." But even if it were considered "retroactive" in prescribing the future treatment of funds already accumulated, it would not thereby become subject to successful attack. In *S.E.C. v. Chenery Corp.*, *supra*, the Supreme Court laid to rest the shibboleth that "retroactivity" is a dirty word the mere incantation of which spells doom to administrative action.¹⁶ The Court there said (332 U.S. at 203-204):

• • • the fact that the Commission's order might retroactively prevent Federal's management from securing the profits and control which were the objects of the preferred stock purchases may well be outweighed by the dangers inherent in such purchases from the statutory standpoint. If that is true, the argument of retroactivity becomes nothing more than a claim that the Commission lacks power to enforce the standards of the Act in this proceeding. Such a claim deserves rejection.

See, also, *e.g.*, *Speert v. Morgenthau*, 73 AppDC 70, 74, 116 F. 2d 301; *Certified Color Industries Commission v. Secretary of Health*, 283 F. 2d 622, 626 (CA2); *N.L.R.B. v. National Container Corp.*, 211 F. 2d 525, 534-535 (CA2); *Optical Workers' Union v. N.L.R.B.*, 227 F. 2d 687, 691 (CA5), certiorari denied, 351 U.S. 963.

Panhandle's contention would be no more sound as a claim of *res judicata* or estoppel by judgment (Br., p. 19) than it is as an attempted invocation of an estoppel *in pais* even if *Amere* (*Cities of Lexington*) and *Panhandle* (*City of Detroit*) had passed on the issue now presented. In those cases, Panhandle and the Commission were in agreement as

¹⁶ Even in the more traditional and generally less flexible realm of judicial action, "retroactive" reversal or overruling of past decisions is permissible. *Tidal Oil Co. v. Flanagan*, 263 U.S. 444, 450. "There is no vested property right in a court-made rule" and experience under such rule may teach that "it cannot justly be applied." *Catherwood Trust*, 405 Pa. 61, 173 A. 2d 86, 94.

to the treatment of liberalized depreciation and accelerated depreciation. There was no "litigation" between them resulting in a decision in favor of one and adverse to the other. Thus, there would be no basis for an estoppel by judgment between them under any circumstances. *Restatement, Judgments* § 82.

It should be noted further that even when an issue has been judicially litigated, the decision is not immutably frozen for all time even as between the adversary litigants. See, e.g., *United States v. Stone & Downer Co.*, 274 U.S. 225, holding that a decision by the Court of Customs Appeals adverse to the Government on an issue of customs classification was not conclusive in a subsequent case between the Government and the same importer concerning a later importation of the same commodity. Chief Justice Taft there (p. 236) cogently pointed out that the passage of time may bring an increased understanding of the importance and impact of a ruling and the dictates of proper and uniform administration of law will then require its reversal. A change of "legal atmosphere" will warrant reconsideration of prior decisions. *Commissioner of Internal Revenue v. Sunnen*, 333 U.S. 591, 600. An error of law need not be perpetuated but may be corrected in later litigation between the same parties. *Automobile Club v. Commissioner of Internal Revenue*, 353 U.S. 180. See, also, e.g. *Grandview Dairy v. Jones*, 157 F. 2d 5, 9 (CA2), certiorari denied, 329 U.S. 787.

To the extent that Panhandle seeks to rely on any Commission decision which was not judicially reviewed,¹⁷ its contention must be rejected under the "well settled doctrine that *res judicata* and equitable estoppel do not ordinarily apply to decisions of administrative tribunals." *Churchill Tabernacle v. F.C.C.*, 81 AppDC 411, 413, 160 F. 2d 244, 246.

¹⁷ Opinion No. 264, *supra*, 12 FPC 369, and *Amere, supra*, 15 FPC 781, being general rulings rather than "orders", were not reviewable. *Magnolia Petroleum Corp. v. F.P.C.*, 236 F. 2d 785 (CA5), certiorari denied, 352 U.S. 968; *Cities of Lexington, et al. v. F.P.C.*, *supra*, CADC No. 13590.

To the limited extent that some adaptation of the judicial concept of *res judicata* or estoppel by judgment has been applied to administrative action, it has always been in situations in which the prior decisions were rendered in quasi-judicial proceedings and involved findings of facts subject to judicial review.¹⁸ Such was the situation in *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381; *N.L.R.B. v. Brown and Root*, 203 F. 2d 139 (CA8); and *H.S.D. Co. v. Kavanagh*, 191 F. 2d 831 (CA6), cited by Panhandle (Br., pp. 18-19). The present decision was not a factual one dependent on the specific evidence in this case, but rather resolved "a difference of judgment on debatable theory as to the most satisfactory way of estimating a fair rate of return." *Panhandle Eastern Pipe Line Co. v. F.P.C.*, 236 F. 2d 606, 610 (CA3). See *N.L.R.B. v. Seven-Up Co.*, *supra*, 344 U.S. at 348.

When Panhandle presented to the Court of Appeals for the Third Circuit much the same argument as it advances in the present case, and, as it does here (Br., p. 18), cited *In re Federal Water and Gas Corp.*, 188 F. 2d 100 (CA3), certiorari denied *sub nom. Chenery Corp. v. S.E.C.*, 341 U.S. 953, Judge Maris, for the court, said (*Panhandle Eastern Pipe Line Co. v. F.P.C.*, 236 F. 2d 289, 292):

In the first place the doctrine of *res judicata* can have no application to a proceeding, such as this, which involves a determination of the present or future public convenience or necessity with respect to the continuance or abandonment of natural gas service. * * * In a situation such as this the Commission is exercising delegated legislative power to make a rule to guide the conduct of the parties in the future. It is not exercising quasi-judicial power to determine past or present rights or liabilities, as was done in the case of *In re Federal Water and Gas Corp.* * * * That

¹⁸ Non-reviewable decisions cannot be given binding effect even as to factual determinations. *United Insurance Co. of America v. N.L.R.B.*, 272 F. 2d 446 (CA7).

case, upon which Panhandle relies, has no relevance here.¹⁹

Rate-making, like licensing or certification, has long been recognized as essentially a quasi-legislative rather than a quasi-judicial function. *E.g.*, *Los Angeles Gas and Electric Co. v. Railroad Commission of California*, 289 U.S. 287, 304.

Thus, no matter how much the boundaries of estoppel might be stretched, they could not conceivably or arguably encompass the situation here presented.

B. An Administrative Decision is Not Invalid Because It Announces a New Policy

The foregoing discussion of the law of estoppel as applied to administrative action *a fortiori* disposes of Panhandle's apparent contention (Br., pp. 13-17) that Commission decisions in unrelated cases precluded its present exercise of judgment and discretion.

As previously observed, the Commission's early decisions in this field were concerned with questions of allowable operating expenses and the accounting procedures to be followed for the tax deferrals resulting from the normalization of taxes in computing operating expenses.

In *United Fuel Gas Co.*, 23 FPC 127, cited by Panhandle (Br., pp. 4, 13), the Commission dealt with liberalized depreciation in its effect on operating expenses, the rate of return having been stipulated (p. 129). In a supplemental opinion in that proceeding, the Commission expressly said (23 FPC 512, 513-514):

• • • As indicated in our *El Paso* opinion [22 FPC 260, 267], the amounts credited to the appropriate account for deferred taxes might have a favorable effect on the company's cost of money and the Commission might consider, in a future proceeding, whether to reflect this tendency in determining a fair rate of return.

¹⁹ As an alternative ground for its decision, the court showed that the prior F.P.C. decision there referred to by Panhandle did not stand for the holding attributed to it. The court referred to Panhandle's reliance on the holding as "so wholly lacking in merit as to border on the frivolous." 236 F. 2d at 293.

In sustaining the Commission's treatment of liberalized depreciation, the Court of Appeals expressly said it was "not concerned here with the question whether or not the tax deferral fund should be included in the rate base upon which the utility is entitled to a reasonable rate of return," noting the Commission's allowance of 1.5% in *Northern Natural Gas Co.*, Opinion No. 342, 25 FPC 431, and in *Kansas-Nebraska Natural Gas Co.*, Opinion No. 343, 25 FPC 448. *Cities of Lexington et al. v. F.P.C.*, *supra.*, 295 F. 2d at 113 n. 2.

In August, 1960, seven months before the issuance of the present order, the Commission made it clear that, while it was rejecting its staff's contention that deferred tax reserves should be considered as "a long term loan at zero interest," it was leaving for future decision "the issue of the proper treatment of the deferred taxes." *Tennessee Gas Transmission Co.*, 24 FPC 204, 206, set aside on other grounds, *Tennessee Gas Transmission Co. v. F.P.C.*, 293 F. 2d 761 (CA5).

As Panhandle has observed (Br., pp. 13-84), in *Phillips Petroleum Co.*, 24 FPC 537 (sustained without discussion of the present issue, *Wisconsin v. F.P.C.*, AppDC , F. 2d), the Commission affirmed an examiner's

ruling that the deferred tax reserves should not be included as interest-free debt capital in computing a rate of return. The effect of this ruling was not crucial to the decision there reached to terminate the rate proceeding, in view of the relatively small amount of the accumulated tax reserves, and no consideration was given to possible alternatives to or modifications of the staff's position.

When the Commission was confronted with cases in which deferred tax reserves had been accumulated in sufficient volume to have a significant effect on rates, it examined the matter in detail and thereupon, in the *Northern* case, issued Opinion No. 342, setting forth the Commission's general policy as of that time.

The Commission has both the right and the obligation to reexamine its policies in the light of developing facts and accumulating experience. Such continuing examina-

tion is especially appropriate in the instant situation, where the Commission's present policies provide for the creation of reserves the amount and need of which may, with the passage of time, vary so substantially as to require a change in regulatory treatment. Such changes, and other variable factors, must at all times dictate the Commission's decisions, which cannot be rendered in slavish obeisance to past decisions. *Cf. United States v. Stone & Downer Co., supra*, 274 U.S. at 236.

The Commission may have occasion to reexamine the question raised in the present case. But such future re-examination, even if it results in a different resolution of the issue, will not detract from the fact that the instant decision is within the allowable range of agency discretion.

The issue in this case is not what policy the Commission may or may not have adopted in other cases in the past, but simply "whether the end result is a reasonable one." *Montana Power Co. v. F.P.C.*, — AppDC —, F. 2d —, Nos. 15,480 and 16,359, decided Jan. 25, 1962, slip op. p. 11. Panhandle has not shown that the result here is unreasonable.

CONCLUSION

For the foregoing reasons, the petition should be denied and the Commission's order should be affirmed.

Respectfully submitted,

RALPH S. SPRITZER,
General Counsel,

HOWARD E. WAHRENBROCK,
Solicitor,

ABRAHAM B. SPALTER,
Assistant General Counsel,

JOSEPHINE H. KLEIN,
Attorney,
For respondent.

Federal Power Commission,
Washington 25, D.C.

January 29, 1962

APPENDIX

NORTHERN NATURAL GAS COMPANY	Docket No. G-19040
PERMIAN BASIN PIPELINE COMPANY	Docket No. G-19041
(now merged into Northern)	

Opinion No. 342

OPINION AND ORDER DETERMINING RATE OF RETURN, DEFERRING DECISION ON ALLOCATION OF SYSTEM COSTS, DISALLOWING PROPOSED INCREASED RATES, DIRECTING PAYMENT OF REFUNDS, AND PERMITTING SUBSTITUTION OF LOWER INTERIM RATES

(Issued March 7, 1961)

This pipeline rate case is before us under the interim order procedure we have applied in recent cases¹ providing for hearing and decision of particular issues susceptible of being decided prior to the completion of the entire hearing. It arose on the filing on June 26, 1959, by Northern Natural Gas Company (Northern) and its then wholly-owned subsidiary, Permian Basin Pipeline Company (Permian), of proposed increased rates under Section 4(d) of the Natural Gas Act (Act).

• • •

RATE OF RETURN

Northern has opposed the determination of the rate of return and allocation issues in advance of fixing final rate levels and costs of service. Northern contends 1) that any increase in its proposed commodity rates will cause an immediate loss of sales and might result in interim revenues insufficient to recover the total costs of service finally determined to be proper; and 2) that the possibility of a reduction in sales volumes should be taken into account in arriving at a fair rate of return, but that the extent of this risk cannot be evaluated until final costs and rate

¹ See Commission orders issued July 8, 1960, in *Southern Natural Gas Company*, Docket No. G-20509, 24 F.P.C. 26, and August 9, 1960, in *Tennessee Gas Transmission Company*, Docket No. G-19983, F.P.C. .

levels are known. However, no such risk will be created by the present order since we have decided, as more fully set forth hereinafter, to defer final determination of the demand and commodity levels of Northern's rates and to use for purposes of interim refunds the allocation of costs of service proposed by Northern.

For the reasons discussed below, we conclude that 10.5 percent is the appropriate return on Northern's equity capital, and that Northern should be allowed to earn 1.5 percent on its deferred income tax accruals. On this basis, the fair and reasonable over-all return of 6.25 percent to be applied to Northern's net investment rate base is calculated as follows:

Consolidated capitalization of Northern
Gas system, December 31, 1959

	Amount	Ratio	Cost	Return
Long-term debt	\$243,311,000	53.50%	4.01%	2.15
Accumulated deferred taxes on income	8,376,740	1.84	1.50	.03
Preferred stock	60,412,500	13.29	5.88	.78
Common equity	142,650,748	31.37	10.50	3.29
Over-all return:				6.25%

Return on deferred income tax accruals. The question of the proper treatment, in fixing rates of return, of amounts accumulated in a deferred tax account by reason of a company's election to use liberalized depreciation, as provided in Section 167 of the Internal Revenue Code, has not yet been determined by us. The increasing importance of this question is indicated by the extent of these tax accruals. In Northern's case, as shown above, they amount to in excess of eight million dollars. Based on reports by the companies to the Commission, it appears that the amount of such accruals in the year 1959 by natural-gas pipeline companies subject to Commission jurisdiction aggregates some \$39,000,000; and total accruals by such companies to date approach \$110,000,000. The question of how

to treat these accruals is now directly before us in the present Northern proceeding and a determination must now be made that will affect other proceedings before us and those that will arise in the future.

Our previous determinations with respect to the treatment of liberalized depreciation have not dealt with the computation of rate of return but rather the question of the normalization of taxes. That is, whether a natural-gas company should be permitted to compute its income taxes for rate-making purposes on the basis of normal straight-line depreciation while using the liberalized depreciation method permitted by Section 167 in its tax returns. As compared with straight-line depreciation, the liberalized method provides higher depreciation deductions, resulting in lower taxes, during the early part of the life of a given property, while lower deductions and higher taxes result in the later years of the life of the property. The total depreciation deductions available to a company over the entire life of a facility and the total tax results of such deductions are the same using either method or a combination of the two. The comparative advantage provided by the statute allowing liberalized depreciation is that it defers to the later life of a given property a portion of the taxes on income that would be payable in the early years under straight-line depreciation, and gives the company the use of such moneys in the interval.

In the *Amere* case,⁵ the company and others filed a petition requesting us to issue a declaratory order to remove uncertainty relating to the treatment of liberalized depreciation. We affirmed our presiding examiner who concluded that the tax allowance to be included in the company's cost of service should be normalized to conform to the straight-line depreciation methods normally used under our Uniform System of Accounts, but that any portion of the tax allowance not actually paid in a given year, that is, the deferred taxes, should be reserved in a special account to cover the amounts by which future taxes would be

⁵ *Amere Gas Utilities Co., et al.*, 15 FPC 781.

greater than the normalized taxes reflected in rates. This treatment of liberalized depreciation distributes the tax and rate effects of depreciation expense equitably over the productive life of a facility and implements the Congressional intent to allow regulated industries, like other industries, thus to provide all or at least a portion of the additional capital needed for desired expansion.

Order No. 203, 19 FPC 826, put these conclusions into effect by amending the Uniform System of Accounts to include a new Account 266,⁶ Accumulated Deferred Taxes on Income, to be credited with amounts by which income taxes paid were lower than normal because of the use of liberalized depreciation and correspondingly debited when taxes become higher than normal.⁷ We have thus allowed companies such as Northern to accumulate substantial sums in these deferred tax accounts and to invest these amounts in company facilities. The further question now presented is what return, if any, should the gas industry subject to our jurisdiction be allowed to earn on the portion of its capital investment so accumulated.

The position taken by the staff in this and other proceedings is that the accumulated deferred tax funds should be included as a part of the capital structure of the company at a zero rate of return. Staff argues that it would be erroneous to exclude Northern's accumulated deferred taxes from a factual statement of company capital, even though it does not constitute actual debt liability, since these funds, which were supplied by the consumer, are available for any corporate purpose except dividend payments, including investment in facilities on which the company would expect to be allowed a rate of return. Accordingly, staff contends that this amount may appropriately be included

⁶ Redesignated Account 281, effective January 1, 1961.

⁷ This same treatment is accorded deferred taxes accumulated using accelerated amortization for tax purposes, as permitted by Section 168 of the Internal Revenue Code. Order No. 171, 13 FPC , April 21, 1954; *Panhandle Eastern Pipeline Co.*, 13 FPC , Opinion No. 269, April 15, 1954.

as debt in determining the relative proportions of debt and equity. Furthermore, it contends that such amount should be included at zero cost since the consumer provides these funds through the payment of rates at no cost to the company. Under staff's approach, the percentage of debt capitalization would be increased to 55.34 percent and the over-all cost of debt would be reduced from 4.01 percent to 3.88 percent. This would leave the same return of 2.15 percent on debt including deferred taxes and would reduce the over-all return to 6.22 percent.

Northern on the other hand, takes the position that it should be permitted to invest the tax accruals in facilities, which would become a part of its rate base, without including such investment as a part of its capital structure and without requiring any reduction in the rate of return to take account of the earnings from such facilities.

Northern argues that the funds represented by tax reserves are not contributed by nor do they belong to the customer, who under prescribed accounting procedures pays the same amount for income taxes whether or not the company takes advantage of the liberalized depreciation provisions of the Internal Revenue Code. If the company owns the funds, says Northern, the company's profitable use of such funds intended by Congress, including even their possible investment in non-regulated business, should not be precluded by regulatory action. Northern suggests that without the prospect of earning a return on the funds so provided, there would be little reason for the utility management to elect a rapid depreciation. It further suggests that allowing such funds to earn a return might improve a natural-gas company's financial standing and reduce its costs of financing, thereby benefitting its customers. Northern would thus use a capitalization excluding the deferred tax item composed of debt 54.5 percent, preferred stock 13.5 percent, and common equity 32 percent. Applying a 10.5 percent rate of return on equity to this

capital structure would result in a return to Northern of 6.34 percent computed as follows:

	Ratio	Cost	Return
Debt	54.5%	4.01	2.19%
Preferred Stock	13.5%	5.88	.79%
Common Equity	32.0%	10.5	3.36%
Over-all Return			6.34%

The use of liberalized depreciation by companies subject to Federal or state regulation has been the source of much litigation. Many jurisdictions have taken the view that a regulated company may not include in its cost of service any larger amount for taxes than the amounts actually paid by it. The effect of this method, commonly referred to as the flow-through method, is to pass on to the rate payers immediately all savings accruing as a result of the use of liberalized depreciation. Other jurisdictions have taken the view that normalization of taxes should be permitted. As stated above, we took this view in our decision in the *Amere* case, *supra*, and adhered to it in our opinion in the *El Paso*⁸ and *United Fuel*⁹ cases. See also *Panhandle Eastern Pipe Line Company*, 13 FPC , Opinion No. 269, dealing with the treatment of accelerated amortization under the provisions of Section 168 of the Internal Revenue Code.

In those jurisdictions which have taken the view that normalization of taxes should be permitted there has been a divergence of views as to how the accumulated tax funds should be treated. Some have been of the view that the amount of accumulated deferred taxes should be deducted from the rate base.¹⁰ Others, including this Commission in the *Panhandle* case, *supra*, have been of a contrary view.

⁸ *El Paso Natural Gas Company*, 22 FPC 260.

⁹ *United Fuel Gas Company*, 23 FPC 127.

¹⁰ See, for example, *City of Alton v. Commerce Commission*, 19 Ill. (2d) 76, 165 N.E. (2d) 513, 522. (This is also the position of the Civil Aeronautics Board and the Interstate Commerce Commission.)

Some jurisdictions have adopted the view, urged by our staff, that the accumulated deferred taxes be included as a part of the capital structure at a zero percent rate of return.¹¹ In New York, the Public Service Commission has held that the benefits of liberalized depreciation should be divided between the ratepayers and the company and has permitted the company to earn a small rate of return on the moneys accumulated from deferred taxes.¹²

Although we have not previously been confronted with this precise question, some aspects of it have been raised in two cases decided by us which have been subsequently appealed to the courts. In both of these cases, the court affirmed our view that normalization of taxes should be permitted. In the *City of Detroit* case,¹³ and appeal of the *Panhandle Eastern Pipe Line Company* decision, *supra*, the Court in discussing the question of whether the accumulated deferred taxes should be deducted from the rate base said:

Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of the deferred taxes to accrue after the five-year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from Section 124A. This statute, unlike the

¹¹ See, *Re Empire District Electric Company*, 23 PUR 3d, 45 (Kansas); *Re Michigan Gas & Electric Company*, 24 PUR 3d, 278 (Michigan); *Re Ohio Fuel Gas Company*, 25 PUR 3d, 207 (Ohio); *Re Pacific Power & Light Company*, 34 PUR 3d, 36 (Oregon).

¹² In *Re Central Hudson Gas & Electric Corporation*, 28 PUR 3d, 317, 320 (1959).

¹³ *City of Detroit v. F.P.C.*, 230 F. 2d, 810 (CADC 1955).

Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms the petitioners. We think this is the result sought by Congress.

In the *El Paso* case,¹⁴ an appeal of the *El Paso* decision, *supra*, the court in discussing our treatment of liberalized depreciation said:

• • • It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequence of rate regulation. • • •

• • •

• • • Therefore, we approve the Commission's treatment of the "saving" resulting from using the declining balance method of depreciation for tax purposes but computing its taxes for rate making purposes on the straight line method of depreciation, placing such "savings" in a special reserve to be used to equalize tax payments in later years. These amounts can never represent added return to the company because of the restriction as to their use. • • •

Although the question of what consideration should be accorded the amounts in the deferred tax accounts was not directly before either of these courts, it would seem that, as urged by Northern, the *City of Detroit* case supports its point of view, while the *El Paso* case would seem to support the staff's view.

¹⁴ *El Paso Natural Gas Company v. F.P.C.*, 281 F. 2d 567 (CA5, 1960).

It is true that the *City of Detroit* case dealt with accelerated amortization only and the *El Paso* case with liberalized depreciation, and different statutes having a different legislative background are involved. We believe it wiser not to attempt to distinguish between these two statutes but to adopt the same view as to all tax accruals, whether obtained from use of Section 167, dealing with liberalized depreciation, or Section 168, dealing with accelerated amortization.

The *Panhandle* (City of Detroit) case was considered by us shortly after the enactment of Section 168. At that time, neither we nor the courts were fully aware of all of the consequences which would result if moneys in the deferred tax accounts were considered as belonging solely to the company. Thus, the statement in the above quotation from the *City of Detroit* case that to permit the company to use the funds for income-producing purposes would not result in higher rates to the consumer has on more careful consideration been disclosed to be erroneous.

If we were to adopt the view urged on us by Northern and the apparent view of the court in the *City of Detroit* case that moneys in the deferred tax account were the company's money and that it was entitled to all income produced from such moneys, it would be necessary to include in the cost of service an additional sum of 108.33 percent (the ratio which the 52 percent corporate income tax rate bears to the amount of 48 percent retained by the taxpayer) of the amount earned on such moneys for the payment of Federal income taxes. To illustrate this point, in the present case if the \$8,376,740 in Northern's deferred tax account is neither deducted from the rate base nor included in the capital structure at less than the $6\frac{1}{4}$ percent rate of return prescribed for Northern, Northern will presumably earn on this money at the allowed rate of $6\frac{1}{4}$ percent a sum of approximately \$523,500.00. However, this will increase its actual Federal income taxes by \$567,125.00. Since Northern is entitled to include its actual taxes in its cost of service, the ratepayer would be required to pay this additional sum and would be penalized in this amount

by reason of the fact that Northern took advantage of liberalized depreciation.

In the case of those companies operating in states having corporate income taxes, an additional amount would have to be included in the cost of service as an allowance for state income taxes.

Furthermore, our staff argues that if Northern, instead of obtaining these sums through use of the liberalized depreciation, had borrowed this amount on the market at the prevailing rate, the entire amount of interest would have been deductible for tax computation purposes and the amount of taxes included in the cost of service reduced. Thus, assuming that Northern had borrowed this money at 5 percent, its interest cost of \$418,800 (5 percent of \$8,376,740) would have been a further deduction in the computation of its income taxes, resulting in a lowering of the amount of Federal income taxes to be included in its cost of service by \$218,780 (52 percent of \$418,000). Although we consider it unrealistic to assume that a company would borrow as senior debt all of the moneys needed by it, and that it would be more fair to consider that additional moneys would be obtained without substantial change in the existing ratio between debt and equity, it is entirely possible that in some instances all of the money would be borrowed. In such cases, the use of liberalized depreciation would require higher rates to be paid by the ratepayer unless the rate of return allowed on the deferred tax moneys was fixed so that the combined return and associated taxes would be less than the return in the event the moneys were raised through the issuance of bonds or other debt securities.

Since use of liberalized depreciation without either deducting the accrued tax deferrals from the rate base, or taking them into consideration in fixing a rate of return requires the ratepayer to pay more than he would be required to pay if liberalized depreciation were not used, we must reject the company's position.

While we thus believe it is necessary to reject Northern's contention we must for equally sound reasons reject the

contention of our staff that the accrued deferred taxes should be included in the capital structure at zero percent interest. The treatment suggested by staff would deprive the company of any earnings from the accumulated deferred taxes and would have the same practical effect as though the amount of deferred taxes were excluded from the rate base. This would deprive the company of most of the benefits arising from use of liberalized depreciation. Northern and other companies appearing before us have stated that if this is done that no valid reason exists for continuing to take advantage of the liberalized depreciation statute and that they may return to straight-line depreciation in the computation of their Federal income tax liability. Experience has shown that this is not an idle threat. Many, probably a majority of the companies regulated by commissions which have required that the benefits accruing as a result of the use of liberalized depreciation be passed on to the ratepayer, either by adoption of the flow-through method, or by requiring that the accrued deferred taxes be deducted from the rate base, have ceased to take advantage of Section 167 of the Internal Revenue Act and have returned to straight-line depreciation in the computation of their income taxes.¹⁵

It is obvious that Section 167 affords definite advantages over the use of straight-line depreciation in that it lowers the amount of taxes currently payable. The use of the moneys not currently paid to the Treasury as taxes is a definite material advantage to the person having the use of such moneys. To adopt a policy which would give all of this advantage to the ratepayer and none to the company, and which, as experience has shown, will very probably result in the failure of the company to use liberalized depreciation, would be extremely shortsighted on our part.

¹⁵ Many electric companies over which both this Commission and state commissions have accounting or rate jurisdiction, whose principal operations are in a state that has required flow-through or deduction from the rate base for rate-making purposes have notified this Commission that they are no longer taking advantage of liberalized depreciation under Section 167. We are advised that a majority of the regulated companies in such states have ceased to use liberalized depreciation.

In our view, the best solution to this problem is to divide the benefits of liberalized depreciation between the regulated company and the ratepayer. In dividing these benefits between the ratepayer and the company, we are guided by the principle that it is our duty to protect the consumer, and adopt rate-making principles which will assure the lowest possible rates. Accordingly, we believe that the major portion of the benefits accruing from the use of liberalized depreciation should go to the ratepayer, and the company should be allowed only so much of the benefits accruing from the use of liberalized depreciation as is necessary to provide it with a sufficient incentive to continue to use liberalized depreciation, and not return to the use of straight-line depreciation in the computation of its income taxes. How much of a return should be allowed on the moneys in the deferred tax account to assure their continued use is largely a matter of judgment based upon such factors as our knowledge of the money market, and our estimate as to what course most regulated companies will elect to pursue in the future. After careful consideration of all of the various factors involved, we are of the opinion that a return of 1.5 percent on moneys in the deferred tax account is a sufficient incentive to a regulated company to induce it to take advantage of the provisions of Section 167. We are further of the opinion that any figure appreciably lower than this will probably cause the company to return to the use of straight-line depreciation with its corresponding loss of benefits to the ratepayer.

Assuming a 10.5 percent return on equity, the allowance of a 1.5 percent return on the deferred tax account moneys results in a return of 6.25 percent to Northern as compared with a return of 6.34 percent if we allowed the company the same return on the tax moneys as it earns over-all, or a return of 6.22 percent if the staff view of a zero percent return on the deferred tax moneys were adopted.

Although our decision to allow a return of 1.5 percent is largely a matter of judgment as to what return we believe necessary to serve as an incentive to induce Northern to continue to use liberalized depreciation, it is supported by

various computations. If, having allowed Northern a return of 6.25 percent, it should decide to go into the market to borrow money instead of raising it by use of the liberalized depreciation provisions of the income tax law, it would probably have to pay in the neighborhood of 4.5 percent to 5.0 percent for its senior debt money under present market conditions. This would result in a net return to existing stockholders of 1.25 percent to 1.75 percent¹⁶ on the borrowed money. To allow less than 1.5 percent return on the deferred taxes would mean that it might be more profitable for Northern's stockholders to enter the money market and borrow this money rather than take advantage of the provisions of Section 167.

We have stated earlier that it is probably neither fair nor realistic to assume that Northern will borrow all of this money. Accordingly, we have considered what would happen assuming that Northern raised its money in any one of several different ways. For purposes of illustration we have shown on the attached table the return to the company and the cost to the ratepayer of raising capital from average industry sources.¹⁷ From this example it is apparent that the cost to the ratepayer if Northern would use straight-line depreciation and raise its capital through ordinary industry sources would be \$716,000 more per year than if it used liberalized depreciation, while the increased benefit to the company stockholders would be only \$150,000. (This increased benefit would, of course, go to more stockholders since the example assumes the raising of additional equity). Consideration of this and other similar examples lends support to our conclusion that a figure of 1.5 percent provides a reasonable, but not excessive, incentive to Northern.

¹⁶ This is a rough computation only, and the actual net return to the stockholders might be slightly higher.

¹⁷ This illustration of 60 percent debt, 10 percent preferred stock and 30 percent common equity is very close to the average capital structure of major pipeline companies.

\$10,000,000 capital from average industry sources:

	Ratio	Cost*	Over-all Return	Tax Allowance @ 108% of Taxable Net Income		Annual Cost to Ratepayers	Tax Paid	Interest and Preferred Dividends Paid	Net Return to Company
				\$	%				
Long-term Debt \$6,000,000	60	5	3.00 : 300,000	—		300,000	—	300,000	— : —
Preferred Stock \$1,000,000	10	5	0.50 : 50,000	54,000		104,000	54,000	50,000	— : —
Common Equity \$3,000,000	30	10	3.00 : 300,000	324,000		624,000	324,000	—	300,000 : 3.00
			6.50 : 650,000	378,000		1,028,000	378,000	350,000	300,000 : 3.00
\$10,000,000 capital from deferred taxes @ 6.25 percent net return:									
10,000,000	100	6.25	6.25 : 625,000	675,000		1,300,000	675,000	—	625,000 : 6.25
\$10,000,000 capital from deferred taxes @ 1.50 percent net return:									
10,000,000	100	1.50	1.50 : 150,000	162,000		312,000	162,000	—	150,000 : 1.50

* The current cost of debt is actually less than five percent and the dividends paid on preferred stock are greater than five percent. The rounding of these figures simplifies the table without affecting its validity.

Apart from earnings, the use of deferred taxes to supply a portion of the company's capital requirements has certain material advantages. The substantial sums involved are readily available without resort to the market, and such additions to capital serve to reduce the company's debt ratio. The acquisition of plant by use of deferred taxes provides additional security not subject to lien on which new loans can be based, perhaps at lower interest rates than would otherwise be possible.¹⁸ Furthermore, deferred tax funds accumulated between rate cases and invested in plant may, during that period, increase the company's earnings. Finally, the accumulation of deferred taxes increases the company's funds available for expansion without issuing additional common stock. It thus gives the existing stockholders the entire benefit of any earnings from the new investment. Our conclusion, giving due consideration to all the factors involved, is that these advantages, taken with a net return of one and one-half percent, constitute a reasonable and sufficient incentive to the pipeline industry to use liberalized depreciation for tax purposes and secure for its customers the substantial savings made possible by the statute. This mutually beneficial result gives such effect to the purposes of the tax statute as is appropriate within the principles of regulatory law expressed in the Natural Gas Act.

• • •

By the Commission. Commissioner Stueck concurring, filed a separate statement.

Chairman Kuykendall dissenting in part, filed a separate statement.

STUECK, Commissioner, *concurring*:

I concur in the action taken by the majority of the Commission in this case to permit an order to be forthcoming. However, I do so reluctantly since I am not fully convinced that the one and one-half percent rate of return allowed on funds realized by deferment of taxes provides a suffi-

¹⁸ To the extent that lower interest rates result, this will also benefit the consumer.

cient incentive to carry out the intent of Congress to stimulate business activity.

KUTKENDALL, Chairman, *dissenting* in part:

I dissent from the conclusion that

"In our view, the best solution to this problem is to divide the benefits of liberalized depreciation between the regulated company and the ratepayer. In dividing these benefits between the ratepayer and the company, we are guided by the principle that it is our duty to protect the consumer, and adopt rate-making principles which will assure the lowest possible rates. Accordingly, we believe that the major portion of the benefits accruing from the use of liberalized depreciation should go to the ratepayer, and the company should be allowed only so much of the benefits accruing from the use of liberalized depreciation as is necessary to provide it with a sufficient incentive to continue to use liberalized depreciation, and not return to the use of straight line depreciation in the computation of its income taxes."

It is our duty to apply the law (that is section 167 of the Internal Revenue Code), and not our discretion, to the facts before us. We have only the legislative powers which Congress has given us, and have no power to amend section 167, distributing as we see fit the advantages given to the taxpayer by this statute.

We should, as the language of the Court of Appeals in the *City of Detroit* case, *supra*, quoted by the majority, clearly states, allow the taxpayer the full advantage of the tax deferral, but without any disadvantage to the ratepayer. The fact that the court did not mention, and may not, in fact, have considered the possible tax deduction arising by virtue of payment of interest on borrowed money does not alter the principle involved.

My colleagues seem to assume that the amounts accumulated through the deferral of taxes would otherwise be obtained through borrowing, or that, in any event such sums should be treated as the equivalent of debt capital. In my opinion, this is error. Such funds actually are as much

or more akin to equity capital than to debt capital. We recognized this fact in our Order No. 203 amending our uniform system of accounts, 19 FPC 826, when we considered the possibility of setting up the reserve account as earmarked surplus. Our prohibition against payment of dividends from these funds would seem to presuppose that such sums are included in surplus.

The fairest and most logical assumption is that these amounts would have been obtained from the various sources in the same proportion as all of Northern's other capital has been obtained. On this premise, a rate of return of 3.27075% on the capital accumulated from deferred tax accruals will yield Northern the same income it would get if such capital had been obtained through conventional financing and not only will not harm the ratepayer, but will actually benefit him substantially. This is shown by the attached schedule.

Note that by use of conventional financing, it would cost the ratepayers \$891,261 to supply Northern with a rate of return of $6\frac{1}{4}\%$ on an amount equal to the accumulated deferred income taxes, of which \$273,982 would be the net return to Northern. On the other hand, a return of 3.27075% on the capital from deferred tax accruals would yield the same net return to Northern at a cost of only \$569,882 to the ratepayers. Thus the ratepayers would save \$321,379, or 36% of the cost of conventional financing, and Northern would receive 100% of what it would receive if conventional financing were used.

The majority quote the following language from the *El Paso* case, *supra*:

"It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings, as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequence of rate regulation."

This language was used by the court in discussing and disposing of tax savings (percentage depletion and in-

tangible well drilling costs) and does not pertain to tax deferrals, and consequently has no relevance in the majority's opinion.

The following sentence in the *El Paso* opinion, *supra*,

"These amounts can never represent added return to the company because of the restriction as to their use."

does not, I believe, mean that the company cannot invest and earn on the sums accumulated for deferred taxes. It is undisputed that Sec. 167 was enacted specifically for that purpose. In the *El Paso* case, the problem presented to the court was whether liberalized depreciation constituted a tax saving or a tax deferral. There was no issue, such as we have here, as to the effect of a lack of interest payments to be used as a tax deduction, which deduction would be present if conventional financing were used.

What do the words "restriction as to their use" mean? The only restriction I know of is the restriction we have placed against using these funds for the payment of dividends, and that must be the restriction to which the court was referring. In my opinion, the court used the word "return" as a synonym for "dividends."

The views I have expressed herein are, I believe, consistent with section 167 and its legislative history, with the only two court decisions which are controlling (*City of Detroit* and *El Paso, supra*), and are fair to the rate payer; yet they do not constitute a usurpation of the constitutional power of Congress.

• • •

NORTHERN NATURAL GAS COMPANY AND SUBSIDIARIES
Consolidated Capitalization — December 31, 1959

Total Capitalization			Return @ 6½%
	Ratio	Cost	
Debt	54.5%	4.01%	2.18545%
Pfd. Stock	13.5	5.88	0.79380
Com. Equity	32.0	10.22	3.27075
	100.0%		6.25000%

Deferred Federal Income Taxes were \$8,376,740 at Dec. 31, 1959

Deferred Taxes

	Return	Tax Allowance @ 108% of Taxable Income	Annual Cost to Ratepayers	Tax Paid	Interest Paid	Preferred Dividends Paid	Net Return to Common Equity
1. { \$8,376,740 capital from normal industry sources: Debt \$4,565,323 54.5% Pfd. Stock 1,130,860 13.5 Com. Equity 2,680,557 32.0 \$8,376,740 100.0% 6½% return	\$523,546	\$367,715	\$ 891,261	\$367,715	\$183,069	\$66,495	\$273,983
2. { \$8,376,740 capital from deferred tax accruals 6½% return	523,546	565,430	1,089,976	565,430	—	—	523,546
3. { \$8,376,740 capital from deferred tax accruals 3.27075% return	273,983	295,900	569,883	295,900	—	—	273,983

REPLY BRIEF FOR PETITIONER

IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

On Petition to Review and Set Aside Order of the Federal
Power Commission

HARRY S. LITTMAN

DALE A. WRIGHT

RICHARD LITTELL

317 Wyatt Building

Washington 5, D. C.

JOSEPH J. DANIELS

BAKER & DANIELS

810 Fletcher Trust Building

Indianapolis 4, Indiana

ROBERT P. PATTERSON, JR.

PATTERSON, BELKNAP & WEBB

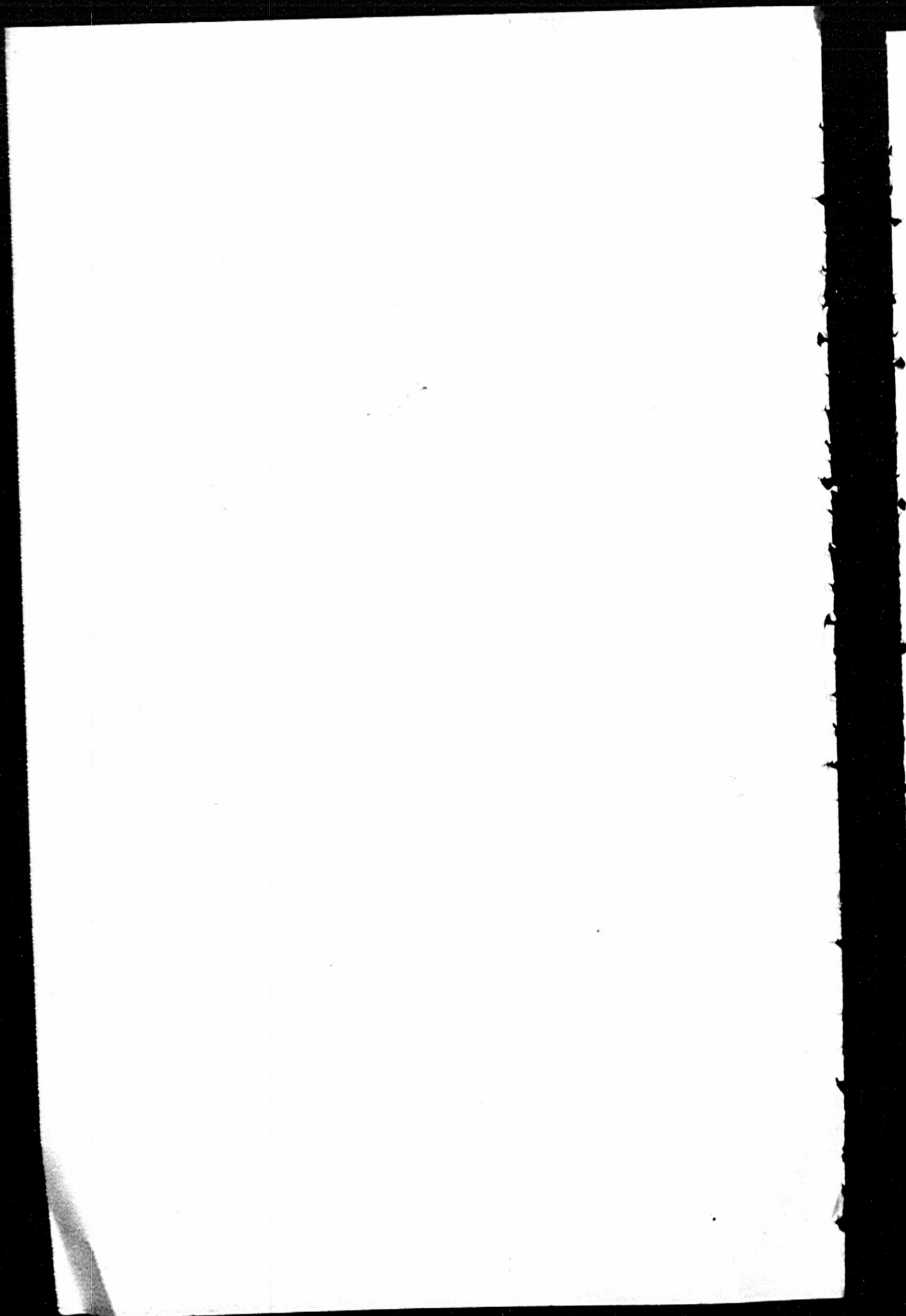
1 Wall Street

New York 5, New York

Attorneys for

Panhandle Eastern Pipe Line Company

February 26, 1962



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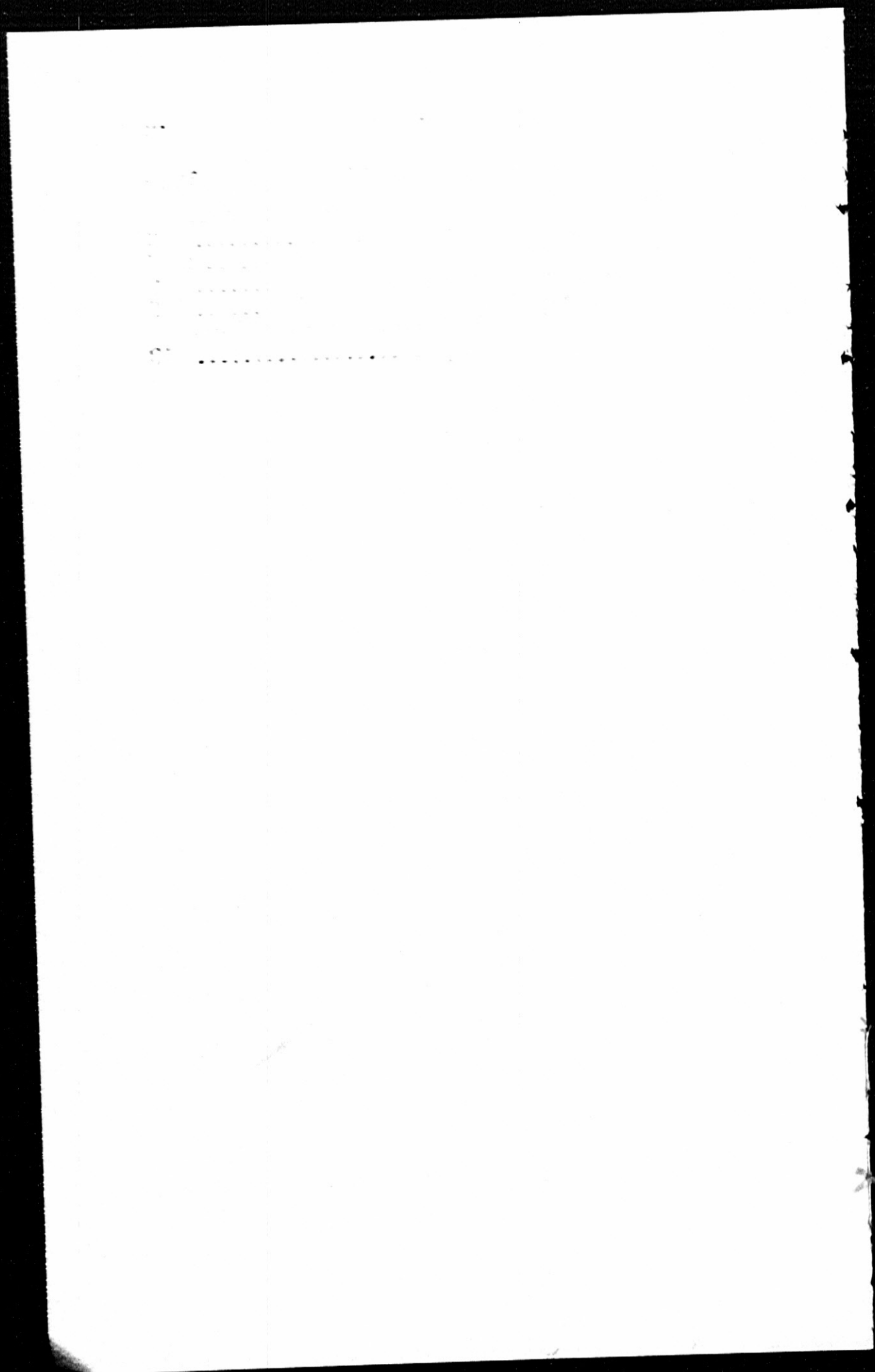
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IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

**REPLY BRIEF FOR PETITIONER
PANHANDLE EASTERN PIPE LINE COMPANY**

**I. THE COMMISSION'S DECISION CANNOT BE SUSTAINED AS A
PROPER EXERCISE OF JUDGMENT AND DISCRETION**

**A. The Commission Has Committed Plain Error by Ignoring
the Intent of Congress**

The Commission asserts (Br., p. 23) that its decision here under review is designed to "allow ratepayers to participate in the benefit from a utility's use of accelerated amortization and liberalized depreciation" With deference, we suggest that this is an understatement in the full sense of the word. What the decision will do, if sustained, will be to take away from the taxpayer substantially all of the benefit which Congress has given it in return for its undertaking construction projects deemed by Congress

to be needed for our national defense and national economy. The Commission is fully aware of this fact. In this situation the fundamental question which this case presents is whether the Commission can thus modify, and in the field of regulated industry effectively destroy, a program which Congress has established to achieve a desired national objective. Tested on this essential point, the decision is unlawful and unreasonable and it must fail.

In its effort to support its invalid action, the Commission contends (Br., p. 12) that its decision is proper because "not a word in the text or legislative history of Section 167 or 168 . . ." indicates that Congress meant that the Commission should allow Panhandle to retain all the benefits of the tax provisions. This contention is without merit and is contrary to previous decisions of the Commission and of this Court.

As shown at pages 13-16 of the Independent Natural Gas Association's brief *amicus curiae*, the legislative history clearly demonstrates that, as the Commission recognizes (Br., p. 12), Congress designed Sections 167 and 168 "to benefit taxpayers, including regulated utilities." Those provisions were "intended generally to foster industrial growth and expansion . . ." (*Id.* at 16). Contrary to the Commission's intimations (*Id.* at 26, 18), Sections 167 and 168 were designed to apply equally to "all segments of the American economy," regardless of degrees of strength or relative risk. See S. Rep. No. 1622, 83rd Cong., 2d Sess. 26 (1954); H. Rep. No. 1337, 83rd Cong., 2d Sess. 24 (1954). See also S. Rep. No. 154, 83rd Cong., 1st Sess. 1 (1953).¹ Furthermore, there is no indication of a Congressional intent to benefit consumers.

¹ Thus, the statement in the Commission's brief that "[a]cceptance of Panhandle's argument would distort congressional intention by providing maximum benefits to those companies which have the least need therefor, i.e., those companies which can readily raise capital at reasonable cost" (Resp. Br., p. 6; see *Id.* at 26), is incorrect.

In numerous decisions the Commission has confirmed that Sections 167 and 168 were not designed to benefit the customers in any part. Speaking of Section 167, the Commission has acknowledged that "the intent of Congress was not to benefit consumers * * *." *El Paso Natural Gas Co.*, 22 F.P.C. 260, 266 (1959), *aff'd as to this issue*, 281 F. 2d 567 (5 Cir. 1960), *cert. denied sub nom. California v. F.P.C.*, 366 U.S. 912.² And regarding Section 168 the Commission ruled recently that "the accelerated amortization provisions were to benefit the taxpayer, not the consumers." *Phillips Petroleum Co.*, 24 F.P.C. 537, 570 (1960), *aff'd* CADC Nos. 16175, *et al.*, — App. D.C. —, — F. 2d — (Nov. 30, 1961).

This Court has also recognized Congress' clear intent. In *City of Detroit v. F.P.C.*, 97 App. D.C. 260, 272, 230 F. 2d 810, 822 (1955), *cert. denied*, 352 U.S. 829, this Court stated regarding what is now Section 168:

"* * * [T]he intent of Congress reflected in Section 124A is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities * * *. This statute, unlike the Natural Gas Act itself, is not for consumer benefit."

The Court also observed that (*Id.* at n. 17):

"* * * [T]here is no indication of a Congressional intent to benefit consumers."

In the face of these pronouncements, the Commission has committed plain error in deciding that "the major portion of the benefits accruing from the use of liberalized depreciation [and accelerated amortization] should go to the ratepayer * * *." Opinion No. 342, *Northern Natural Gas Company*, 25 F.P.C. 431 (Resp. Br., App. 50).³ Indeed, Commission counsel are unable to find any support for this new

² Emphasis is supplied throughout this brief unless otherwise indicated.

³ The portions of Opinion No. 342 relevant to the issue here involved, are reprinted in the Appendix to the Commission's brief and are cited as "Resp. Br., App. —."

position in the statutes or the legislative history and, in fact, now admit "that Congress intended Section 167 and 168 of the Internal Revenue Code to benefit taxpayers" (Resp. Br., p. 12).

B. The Commission May Not Disregard the Intent of Congress on the Pretext of Announcing a New Policy

The Commission contends that its decision "is not invalid because it announces a new policy" (Br., p. 36). But the Commission's new policy is unlawful, not because it is new, but because it is contrary to the intent of Congress.

Where, as here, tax statutes are accompanied by a clear Congressional intent, they do not "simply give rise to additional facts which, along with all other facts, are to be considered . . ." (Resp. Br., p. 5; see *Id.* at 12). Rather Sections 167 and 168 carry a clear legislative command. The Commission is not empowered to emasculate this Congressional mandate under the guise of administrative policy making.

In *El Paso Natural Gas Co.*, *supra*, which the Commission excludes from its citation of prior decisions (Br., pp. 28-38), the Commission acknowledged that the Congressional purpose underlying Section 167 was binding. It stated (22 F.P.C. at 266):

" . . . As the United States Court of appeals noted in the *City of Detroit* case (footnote omitted) with respect to the account for accumulated deferred taxes created in connection with accelerated amortization, the intent of Congress was not to benefit consumers, but to encourage construction. . . . We concluded in the *Amere* case that we could not strike down an Act of Congress and we must apply Section 167 to the natural gas companies."

Similarly, in *Phillips Petroleum Co.*, *supra*, the Commission conceded regarding Section 168 that (24 F.P.C. at 570):

" . . . The accelerated amortization provisions were to benefit the taxpayer, not the consumers. They represent an advantage bestowed by Congress to encourage

the construction of emergency facilities, and *we are not authorized to take away this advantage.* * * *

In short, the Commission must obey the Congressional intent that these tax provisions are "not for consumer benefit * * * and should be given effect as intended by Congress." See *City of Detroit, supra*, 97 App. D.C. at 272, 230 F. 2d at 822.

The Commission's brief underscores the illegality of its present position by announcing that in the future the Commission may "reexamine the question raised in the present case," perhaps with "a different resolution of the issue * * *" (Resp. Br., p. 38). The public interest, however, requires that administrative policies which are tailored to Congress' intent should not be thus lightly cast aside or changed by the administrative agency. Where, as here, the Congressional intent has remained unchanged, there is no justification for sharp reversals of established policy upon which management decisions have been based and investments made in past years.⁴

C. The Commission's Decision Is Clearly Contrary to This Court's Decision in the *City of Detroit* Case

Although the Commission in its brief pays lip service to the decision of this Court in the *City of Detroit* case in acknowledging that "the decision in *City of Detroit* was sound * * *" (Resp. Br., p. 22),⁵ it actually requests that

⁴ As we warned (Br., p. 19), the Commission's cavalier treatment of its prior decisions, if upheld, will mean that Panhandle and other taxpayers subject to the Commission's jurisdiction will be unable to rely in the future on the provisions of Section 167 when considering new construction. For if regulated companies lose 77% of the benefits today, they may well find that tomorrow the Commission will deprive them of 99%.

⁵ The Commission has thus apparently abandoned its former position that that case was wrongly decided. In our Initial Brief (pp. 20-22), we showed that both the Commission and this Court were fully aware of the consequences of their decisions. We further demonstrated (*Id.* at 22-23), that the use of accelerated amortization and liberalized depreciation does not result in higher rates to the utility customers. By its failure to reply to our contentions in this regard, the Commission recognizes that this Court's decision in *City of Detroit* is proper.

City of Detroit be overruled. It does so by arguing that such decision "should be reexamined with a view to recognition of the basically dynamic and fluid effect of accelerated amortization and liberalized depreciation" (Resp. Br., p. 22).

Aside from the fact that it is without any support in the record or in the Commission's findings, Commission counsel's economic hypothesis could provide no basis for revising this Court's ruling in *City of Detroit*. In that case, the Court decided after full argument that it is the taxpayer who was entitled to the benefits of accelerated amortization. It so decided because thereby "the Congressional intent is effectuated." The issue is unchanged today. The Court having reached "the result sought by Congress" (97 App. D.C. at 272, 230 F. 2d at 822), that result should not be altered where, as here, Congress had adhered to its intention that the benefits of the tax provisions should be retained by the taxpayer and not passed on to its customers.

1. The Commission's Decision Is a Device to Circumvent the City of Detroit Decision

Despite its request that *City of Detroit* "should be re-examined," the Commission insists (Br., p. 21) that its decision is "entirely consistent with the Court's decision in *City of Detroit*." According to the Commission, this is because "the reserves have not been deducted from the rate base" Moreover, asserts the Commission, "the issue now presented is not one reached in *City of Detroit*" (*Id.* at 21; see *Id.* at 30-31). There is no substance to these contentions.

The Commission's present decision is actually a device to circumvent this Court's holding in *City of Detroit*. By its decision in *City of Detroit*, this Court approved rates which allowed Panhandle to earn a full rate of return on its entire investment in transmission properties. In contrast, here the Commission is attempting to limit Panhandle to a 1.5

percent allowance on facilities financed by tax accruals, while allowing a full 6.46 percent return only on the remainder of Panhandle's plant (Cf. II-B, *infra*). As we pointed out (Pet. Br., pp. 15-16), the Commission thus accomplishes the same end-result as would be produced by deducting 77 percent of Panhandle's deferred tax accruals from the rate base. Despite the Commission's assertion that there are "important theoretical and practical differences" between allowing a zero return and a 1.5 percent allowance on the facilities financed by the deferred tax accruals (Resp. Br., p. 19), it is apparent that the Commission has now sought to obtain a result which differs only in degree from the proposal to deduct the amount of such tax accruals from the rate base, which proposal was held improper by this Court in *City of Detroit*.

In arguing that Opinion No. 342 and the order under review escape conflict with *City of Detroit* because they are phrased in terms of "fair rate of return," rather than "rate base" (Resp. Br., pp. 21, 30), the Commission resorts to semantics. For in either case the same end-result is achieved (R. 1351-2, 1756, 2485).⁶ Indeed, in Opinion No. 342, the Commission conceded that "it would seem that the * * * *City of Detroit* case supports [the company's] point of view * * *" (Resp. Br., App. 46). This was because the Commission, in Opinion No. 342 (Resp. Br., App. 47) recognized that it was "the apparent view of the court in the *City of Detroit* case that moneys in the deferred tax account were the company's money and that it was entitled to all income produced from such moneys * * *."

2. The Commission Itself Has Recognized That *City of Detroit* Precludes the Result the Commission Now Seeks

That until its issuance of Opinion No. 342 the Commission itself would have viewed its present position as in conflict with *City of Detroit* is apparent from *Phillips*

⁶ The *amicus* brief of the Michigan Public Service Commission frankly admits this fact (Br., p. 8).

Petroleum Co., supra. There the Commission's Staff advocated a proposal which—like the Commission's order under review—would have artificially treated the accrued taxes as though they were a part of the company's capitalization. In rejecting the Staff's proposal, the Examiner stated (24 F.P.C. at 741):

“• • • [I]t constitutes a device designed to pass on to the rate payers a portion of the tax savings which both the Commission and the Court of Appeals in the *City of Detroit* case have held was intended by Congress to inure to the benefit of the certificate holder.”

Although the Commission specifically affirmed the Examiner (24 F.P.C. at 570), it now attempts to distinguish *Phillips* “in view of the relatively small amount of the accumulated tax reserves • • •” (Resp. Br., p. 37). But in *Phillips*, the company's tax accruals amounted to \$19,162,355 (24 F.P.C. at 739), which can hardly be regarded as a “relatively small amount.” In any event, it is undeniable that in *Phillips*—as in its decision affirmed in *City of Detroit*—the Commission derived the fair rate of return on the basis of the company's actual capitalization, without including deferred tax accruals. This, of course, is precisely the method advocated by Panhandle in the instant proceeding and approved by this Court in *City of Detroit*.

D. The Commission's 1.5 Percent Allowance Cannot Be Sustained Either as a Fair Return or as an Adequate Incentive

Throughout its brief, the Commission seeks to convey the impression that its order may be justified as a decision that the “fair rate of return” on Panhandle's tax accruals is 1.5 percent. Thus, on page 21 of its brief, the Commission states that “the issue now presented is • • • what is a fair rate of return on invested capital which includes accumulated deferred tax reserves?” Again, on page 29, it describes “the issue here presented” as “the effect of deferred tax funds on a fair rate of return.” By these means, the Commission advances the argument that its

determination of the 1.5 percent allowance, like "the propriety of any rate of return is, in the last analysis, a matter of judgment, calling for the application of accumulated experience and administrative expertise * * *" (Resp. Br., pp. 23-24).

Although Commission's counsel has on hindsight so characterized the order under review, there can be no doubt that the Commission itself did not even purport to find that the 1.5 percent allowance was a "fair return." On the contrary, in Opinion No. 342, the Commission simply found that "a return of 1.5 percent is * * * what return we believe necessary to serve as an incentive to induce Northern to continue to use liberalized depreciation * * *" (Resp. Br., App. 50). In the order under review, the Commission did no more than apply to Panhandle the same 1.5 percent allowance which it had found applicable to Northern.⁷

The legal infirmities in the Commission's order cannot, of course, be cured by this belated attempt of its counsel to supply different grounds than those relied on by the Commission in arriving at its decision. This is because "the grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based." *S.E.C. v. Chenery Corp.*, 318 U.S. 80, 87 (1943); see also *Boudin v. Dulles*, 98 U.S. App. D.C. 304, 235 F. 2d 532 (1956); *N.L.R.B. v. Capital Transit Co.*, 95 U.S. App. D.C. 310, 221 F. 2d 864 (1955). Accordingly, since the Commission has not found that 1.5 percent constitutes a "fair return," this argument of the Commission's counsel is without merit.

Commission counsel also fail to show any support for the grounds which the Commission actually specified in Opinion No. 342 as the basis for its decision. Although

⁷ In the order under review, the Commission adopted the 1.5 percent figure from its Opinion No. 342 in the *Northern Natural Gas Co.* case, stating: "The principles applied in the *Northern* case are equally applicable to Panhandle in the present case." (R. 3551-2).

Commission counsel assert (Br., p. 25) that the Commission showed "that various mathematical computations tended to support its conclusions," we have demonstrated (Pet. Br., pp. 24-5) that these computations prove that the Commission's 1.5 percent allowance is an insufficient incentive. To be sure, Commission counsel also refer (Resp. Br., p. 24) to the Commission's findings that an adequate incentive is supplied by a number of factors "apart from earnings" But the Commission itself recognized that such factors "'might be too easily offset by disadvantages' to afford the companies adequate incentive" (Resp. Br., p. 25).

Moreover, there is nothing in the record in the instant proceeding to show that such factors would constitute an incentive for Panhandle. For as we pointed out (Pet. Br., p. 25) in an argument which the Commission unfairly distorts (Resp. Br., p. 26), Panhandle would not be induced to elect to use Sections 167 and 168 by factors which might possibly constitute an incentive for other companies. That the factors mentioned by the Commission would not have been a sufficient inducement is shown by Panhandle's repeated insistence from the beginning that it would not elect to take accelerated amortization and liberalized depreciation unless it was assured that it would be permitted to retain the full benefits thereof (R. 1757-9).

Even apart from these deficiencies, the Commission's stated grounds upon which it purported to base its Opinion No. 342 do not justify its decision. As already noted, the Commission's ultimate rationale in arriving at the 1.5 percent allowance was that this was "necessary to serve as an incentive to induce Northern to continue to use liberalized depreciation." Here the Commission completely misconceives the nature and purpose of the "incentive" which must be given effect in the present proceeding.

In enacting Sections 167 and 168, Congress intended to provide not merely an incentive "to use liberalized depre-

ciation' but, as the Commission concedes (Br., p. 16), an incentive "to foster industrial growth and expansion" In lieu of this incentive which Congress intended, the Commission granted a 1.5 percent allowance which was the minimum it "believed" would induce Panhandle to retain its present accounting method. The Commission thus attempted to substitute a so-called "incentive" of its own invention for that which Congress prescribed.

II. PANHANDLE IS ENTITLED TO THE RETURN ON FACILITIES FINANCED BY THE DEFERRED TAX ACCRUALS WHICH THE COMMISSION FOUND JUST AND REASONABLE ON THE BASIS OF ITS TRADITIONAL STANDARDS.

A. Panhandle Is Not Seeking an Excessive Or Unreasonable Return

The Commission's brief contains numerous statements and implications that Panhandle is seeking unreasonable or excessive rates or rates of return (Resp. Br., pp. 5, 6, 9, 10, 11, 12). We emphatically disagree.⁸

In its order below, the Commission explicitly found the proper return for Panhandle's debt, preferred stock and common equity. As Commission counsel concede (Resp. Br., p 8), the weighted average cost of these capital components is "6.46% per annum." Panhandle has accepted these findings for the purpose of this appeal and seeks only to have the Commission apply the return of 6.46 percent, thus determined by the Commission in the traditional manner, to its entire rate base in transmission properties, including the facilities financed initially with deferred tax accruals. Significantly, the Commission does not deny the fact, pointed out in Panhandle's initial brief (at pp. 9-10), that the Commission and the Courts have traditionally determined the fair rate of return of a pipeline company on the basis of its actual capitalization of long-term debt, pre-

⁸ Our search of the order under review (R. 3551-5) and Opinion No. 342 in the *Northern Natural* case (Resp. Br., App. 36, *et seq.*) reveals no language or findings which support the charge in the brief of Commission counsel.

ferred stock and common equity. Surely, the Commission cannot be heard to contend that the over-all rate of return sought by Panhandle of 6.46 percent, determined in the Commission's own traditional manner from the undisputed weighted average cost of Panhandle's actual capitalization, is in any sense excessive or unreasonable.

Despite these facts, however, the Commission attempts to make Panhandle's position appear extreme by accusing Panhandle of claiming "the maximum theoretical monetary benefits" from Sections 167 and 168 (Resp. Br., p. 12). This accusation is demonstrably baseless. If, contrary to fact and the Commission's traditional method of determining return, the deferred tax accruals are to be included in Panhandle's capitalization, they could realistically be considered as common equity for the reasons stated in our Initial Brief (at p. 23). On this basis, the deferred tax accruals would be allowed a return of 10.47 percent instead of the 6.46 percent return claimed by Panhandle on the basis of the traditional method of determining return. It is thus obvious that, far from constituting the "maximum theoretical monetary benefit," the 6.46 percent conventionally determined over-all return is fair and reasonable.

B. The Commission Disregarded Traditional Standards for a Fair Rate of Return by Using an Erroneous and Artificial Statement of Capitalization

The Commission states (Br., p. 8) that "Panhandle's allowable rate of return is properly determinable by traditional standards." However, the Commission fails to state that its decision below violates such traditional standards by the inclusion of the deferred tax reserves in Panhandle's actual capitalization. As previously stated, the Commission and the Courts have traditionally determined the fair rate of return of a pipeline company on the basis of its *actual* capitalization of long-term debt, preferred stock and common equity (See II-A, *supra*, and Pet. Br.,

pp. 9-10). This conventional test has been approved by the Commission as recently as *Phillips Petroleum Co., supra*. 24 F.P.C. at 570, 739-42 (1960).

Prior to the Commission's Opinion No. 342 in *Northern Natural*, which was issued shortly prior to the order under review, the Commission never included deferred tax accruals in such actual capitalization. In the order under review, however, the Commission has diluted the actual cost of Panhandle's true capitalization by adding to such capitalization deferred taxes at an arbitrary allowance of 1.5 percent. The Commission has thus employed a wholly artificial statement of capitalization in order to deprive Panhandle of the major portion of the benefits of its deferred tax accruals.

The Commission's inclusion of deferred tax accruals in Panhandle's capitalization erroneously classifies Panhandle's tax reserves in a manner contrary to fact. Such tax reserves are admittedly "subject to the deferred tax liability" (Resp. Br., p. 10). Indeed, under Sections 281 and 282 of the Commission's Uniform System of Accounts, Panhandle is required to segregate its tax accruals in restricted accounts and is not allowed to "transfer . . . any portion thereof to surplus . . ." (18 C.F.R. §§ 201.281 and 201.282). In these circumstances, Panhandle is required to reflect, and does reflect on its books, its tax accruals as a "deferred liability," and not as part of its "total capitalization" (See Appendix A hereto). For the Commission to do otherwise violates sound practice. See Graham and McGolrick, *The Interpretation of Financial Statements*, 39-41 (1955 Ed.).

Moreover, the Commission's brief further seeks to becloud the true effects of its new formula for determining return by making it appear that it has granted Panhandle the "usual allowance for its conventional capital" plus "a cushion equivalent to 1.5% on the deferred tax reserves"

(Resp. Br., pp. 9, 10). However, the following table⁹ illustrates that by the device of including deferred taxes in Panhandle's capitalization, what Commission counsel refer to as a "cushion" represents, in actuality, a *reduction* in Panhandle's over-all rate of return from 6.46 percent to 6.25 percent.

	Amount	Cost	Traditional Method Based on Actual Capitalization		New Method Based on Artificial Capitalization	
			Ratio	Return	Ratio	Return
Long-Term Debt	\$140,878,000	3.55%	54.62%	1.94%	52.37%	1.86%
Preferred Stock	9,377,700	3.99	3.64	.15	3.49	.14
Common Stock	107,672,124	10.47	41.74	4.37	40.02	4.19
Deferred Taxes	11,076,954	1.50			4.12	.06
			100.00%	6.46%	100.00%	6.25%

Since either rate of return, of course, would be applied to the same rate base investment, it is readily apparent that the Commission's erroneous and artificial restatement of Panhandle's actual capitalization substantially penalizes Panhandle by reducing the rate of return to which it is entitled under the Commission's traditional standards.

C. The Allowance of a Fair Rate of Return on Facilities Financed by Deferred Tax Accruals Would Not Result in Excess Charges to Customers.

The Commission objects to allowing Panhandle the same rate of return (6.46%) on the facilities financed by its deferred tax accruals as that which the Commission found proper for its other facilities on the asserted grounds that it "would result in the ratepayers' being charged \$1,490,831 for Panhandle's use of" deferred tax accruals. According to the Commission, the customers would thus pay "\$715,600 (6.46% on the tax reserves accumulated to date)

⁹ Source: F.P.C. Order dated March 20, 1961 (E. 3551-2); Petitioner's Initial Brief (page 17, note 11).

• • • plus income taxes payable thereon (computed at 108.-33% of the net return)"¹⁰ (Resp. Br., p. 11).

In advancing these objections the Commission's brief ignores the controlling fact that if Panhandle were allowed a rate of return of 6.46 percent on the facilities financed by its deferred tax accruals, its customers would pay virtually the same rate upon the facilities financed by such accruals as they would pay if, instead of electing to use Sections 167 and 168, Panhandle had obtained its financing from its conventional sources of capital. As the Commission correctly stated in *United Fuel Gas Co.*, 23 F.P.C. 512, 513 (1960), *aff'd in part sub nom. Cities of Lexington, etc., Ky. v. F.P.C.*, 295 F. 2d 109 (4 Cir. 1961): "The customer is not injured by liberalized depreciation; it pays a rate as though this tax incentive did not exist."

Indeed, the Commission states in its brief (p. 11) that under a rate of return of 5.45 percent on Panhandle's facilities financed by its accruals and 6.41 percent over-all, the customers would pay "the same capital cost as they would be required to meet if the company were to raise an equivalent amount from outside sources in its present proportions of debt and preferred and common stock" (See Pet. Br., pp. 26-28).

The Commission asserts that ratepayers should be spared these normal capital and tax costs because they "provided the company with funds for the payment of income taxes before the taxes were due" (Resp. Br., p. 11). But the Commission is clearly in error in regarding tax accruals from use of accelerated amortization and liberalized depreciation as contributions by customers. For as the Commission itself acknowledged in *United Fuel Gas Co.*, *supra*, 23 F.P.C. at 513, such funds are tantamount to "a loan not from the customers but from the government."

¹⁰ The Commission also objects to Panhandle's calculated return of 5.45% on the facilities financed by its deferred tax accruals because such return "would cost the ratepayers \$1,258,100, including tax • • •" (Resp. Br., p. 11).

That tax accruals are not customer contributions is emphasized by the Commission's concession that "the company 'owns' the funds" and that it is Panhandle alone which is "subject to the risks of future liability for the 'deferred' income taxes" (Resp Br., pp. 10, 21). And, contrary to the Commission's surmise (*Id.* at 10), Panhandle's use of its tax accruals in company operations entails the normal degree of risk of loss.

The Commission further criticizes Panhandle's proposed rates of return as constituting "the hypothetical monetary return to the company [or] the hypothetical maximum cost to the ratepayer on a nonexistent set of facts . . ." (Resp. Br., p. 12). On the contrary, as conceded elsewhere in the Commission's brief (at p. 8), Panhandle's proposed 6.46 percent rate of return represents the weighted average *actual* cost of its *actual* capitalization of debt, preferred and common equity. This is the very same rate of return which the Commission found fair and reasonable for Panhandle's actual capitalization (See Section II-A, *supra*). As shown above, it is the Commission which advocates a nonfactual "rate of return" computation by artificially restating Panhandle's actual capitalization as though it included deferred taxes.

To be sure, a rate of return of 5.45 percent on Panhandle's facilities financed by tax accruals and 6.41 percent over-all is somewhat less than Panhandle's actual over-all capital cost of 6.46 percent. But Panhandle suggested this rate of return solely in response to Opinion No. 342, in which the Commission purported to base its decision upon this Court's statement in *City of Detroit* that (97 App. D.C. at 272; 230 F. 2d at 822):

" . . . Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress."

As we have shown (Pet. Br., pp. 26-28), a return of 5.45 percent on the facilities financed by deferred tax accruals is the *minimum* that Panhandle must be allowed in order to achieve a result which "neither aids nor harms" its customers even if it is lawful and proper to deprive Panhandle of any part of the benefits of Sections 167 and 168. Any lesser return, such as the 1.5 percent allowed by the Commission, actually "harms" Panhandle and "aids" Panhandle's utility customers, and, in fact, gives such customers a windfall by pre-empting to them the major part of the tax benefits which this Court held in *City of Detroit* were intended solely for the taxpayer. It should also be recognized that the minimum return of 5.45 percent on facilities financed by deferred taxes and 6.41 percent overall is most conservative for the reasons stated in our Initial Brief (at p. 28).

In an argument raised for the first time on brief, Commission counsel contend that the Commission's decision "achieves for regulated natural gas companies a result reasonably in accord with that probably obtained in representative unregulated industries" (Resp. Br., p. 6). According to Commission counsel (Br., pp. 16-19), "it appears to be a matter of plain common sense" that competition requires unregulated enterprises to pass on part of the benefits of the tax provisions in the form of lower prices.

But Commission counsel's assumption about unregulated industries is without any support in the record or in the legislative history of Sections 167 and 168. And as a matter of judgment, both the Commission and this Court could assume more reasonably that all segments of the American economy operated consistently with Congress' intention that Sections 167 and 168 accruals were not for consumer benefit, but for investment in new productive facilities. See *El Paso Natural Gas Co.*, *supra*, 22 F.P.C. at 266. See also S. Rep. No. 154, 83rd Cong., 1st Sess. 3 (1953).

In any event, the Commission did not predicate its decision upon these grounds which its counsel now undertake to supply. Indeed, the question of how unregulated industries treated the benefits of Sections 167 and 168 did not enter into its deliberations. As we pointed out above, the *Chenery* doctrine requires that this Court judge the Commission's order on the grounds upon which the record discloses that the Commission's action was based, not those advocated by the Commission's counsel on hindsight.

D. Panhandle's Position Is Consistent with Judicial Decisions

Although the Commission's brief (pp. 12-14) cites *Cities of Lexington, etc., Ky. v. F.P.C., supra*, and *El Paso Natural Gas Co. v. F.P.C., supra*, neither decision suggests that Panhandle's rates would be excessive if the company retained the benefits of Sections 167 and 168. In referring to the "tax savings" which were involved in those cases (281 F. 2d at 573), the Fourth and Fifth Circuits were not concerned with *tax deferrals* under Sections 167 and 168, but only with the *tax savings* resulting from the deductions from percentage depletion and intangible well-drilling and development costs allowed to producers of natural gas by Internal Revenue Code Sections 611-613 and 263(c), 26 U.S.C.A. §§ 611-613 and 263(c). From these opinions it is apparent that the Courts' decisions were bottomed on the proposition that such deductions constituted "actual savings in taxes," or "true tax savings" (281 F. 2d at 573; see 295 F. 2d at 117).

Unlike the provisions for percentage depletion and intangibles, however, Section 167 (and Section 168) "works a tax deferral, rather than a tax savings" (281 F. 2d at 573). As the Commission itself has recognized, for rate of return purposes it must treat tax deferrals differently from tax savings. *United Fuel Gas Co., supra* (23 F.P.C. at 513). Because of this fundamental distinction between tax savings and tax deferrals, the Commission's quota-

tions from *Cities of Lexington* and *El Paso* do not support its treatment of Panhandle's tax accruals.

Indeed, although neither *Cities of Lexington* nor *El Paso* dealt with the question "considered by the Commission in Northern Natural Gas [Opinion No. 342] * * *" (295 F. 2d at 113, n. 2), both decisions tend to support Panhandle's position, not that of the Commission. This is because in both proceedings the Courts sustained the Commission's refusal to deprive the companies of the benefits of Section 167.

The Commission further asserts (Br., pp. 14-15) that, if it had allowed Panhandle to retain the benefits of Sections 167 and 168, it "might well have run afoul of this Court's unequivocal admonition in *City of Detroit v. F.P.C.*, *supra*," relating to fair field prices. There, where the Commission decided to increase rates for the purpose of encouraging gas production activities by pipelines, the Court held that the Commission must limit the increase to the amount needed to provide the desired incentive. The Court added: "Further than this we think the Commission cannot go without additional authority from Congress" (97 App. D.C. at 267, 230 F. 2d at 817). In contrast, here Congress has made clear its intention that the company is entitled to retain the entire benefits of Sections 167 and 168. Thus Panhandle requests exactly what Congress intended for it, and no more. Panhandle is therefore not required, as the Commission suggests (Br., p. 15), to make an evidentiary showing that "the return it requests on its deferred tax reserves is the minimum necessary to effectuate the claimed congressional intention or to achieve any other proper purpose." Indeed, this Court's decision in *City of Detroit* supports our position because there the Court held as a matter of law that the Commission's allowance to Panhandle of a fair return on its tax accruals achieved "the result sought by Congress" (97 App. D.C. at 272, 230 F. 2d at 822).

In short, to allow Panhandle to earn a full return on its facilities financed by tax accruals would not result in "rates in excess of reasonable rates." Under traditional regulatory standards, there is no reason why customers should not pay the company a fair return upon the entire corporate investment in facilities devoted to customer service. "This does not allow Panhandle for rate purposes more than a fair return over the long period, but does recognize the grant by Congress of certain temporary tax savings * * *." See *City of Detroit v. F.P.C.*, *supra*, 97 App. D.C. at 271, 230 F. 2d at 821, quoting 13 F.P.C. 53, 83.

III. THE COMMISSION WRONGFULLY DEPARTED FROM ITS PRIOR DETERMINATIONS

By focusing its reply upon the technical doctrines of estoppel (Resp. Br., pp. 28-38), which Panhandle did not invoke, the Commission disregards our contention that it acted arbitrarily in departing from its judicially-approved decisions which Panhandle sought, obtained and relied upon. Indeed, the Commission fails to come to grips with Panhandle's contention that the order under review is unlawful because of the lack of fundamental fairness and administrative integrity in the Commission's attempt to ignore its past decisions and to deprive Panhandle of the major part of the benefits of its deferred tax accruals.

At the outset, the Commission seeks to escape the effects of its earlier decisions by asserting that "none * * * was concerned with the issue here presented" (Resp. Br., p. 29; see *Id.* at 30, 36-37). As we explained earlier (Pet. Br., p. 20), however, whether formulated in terms of rate of return or tax allowance, each of the Commission's prior decisions, issued after extensive hearings and deliberate consideration, stated unequivocally that the benefits of Sections 167 and 168 were intended to be retained by the taxpayer and should not be passed to customers, either directly or indirectly. The plain fact is that in order for Panhandle to benefit from Sections 167 and 168, the com-

pany must be allowed to invest funds temporarily accrued under those sections and to earn a full return thereon. For as even the Commission conceded in Opinion No. 342 (Resp. Br., App. 51-2), a natural-gas company could have earned substantially more than 1.5 percent on such facilities if it had not financed them by use of the deferred tax accruals, but instead, had raised such capital from "average industry sources." Moreover, that Panhandle benefits from deferred tax accruals only if it has the right to invest such funds and earn a full fair return thereon was recognized by this Court in *City of Detroit* in stating (97 App. D.C. at 272, 230 F. 2d at 822):

"* * * the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle would benefit substantially from section 124A (footnote omitted)." * * *

Indeed, at page 21, note 12 of its brief, the Commission states that in *City of Detroit* this Court accepted Panhandle's position that the company "would be entitled to its 'full' rate of return * * *" on its tax accruals.

In an attempt to avoid the force of Panhandle's contention that the Commission has reversed itself arbitrarily, the Commission emphasizes a quotation from the Presiding Examiners decision in *Amere*, 15 F.P.C. 760 (Resp. Br., pp. 30-1). To be sure, the Examiner there stated that "Petitioners do not now request a determination as to the ultimate treatment of the reserve for deferred taxes for rate purposes. * * *" 15 F.P.C. at 763. But the Examiner was there describing the position of the original "petitioners," not of Panhandle, which was an "intervenor." Indeed, as the Examiner noted, Panhandle contended that the Commission should "state definitely and clearly its policy respecting the effect of the use of liberalized deprecia-

tion on the rates to consumers."¹¹ 15 F.P.C. 760 at 765. Furthermore, at the end of his decision, the Examiner clearly discussed the right which natural gas companies would have to earn their normal return on facilities financed with deferred tax accruals. Thus, the Commission's attempt to limit the scope of its ruling in the *Amere* case is without merit.

In any event, the Commission is wrong when it asserts that none of its prior decisions "involved or decided the rate of return issue presented in the instant case" (Resp. Br., p. 31). As shown above and elsewhere (Pet. Br., pp. 13-14), in *Phillips Petroleum Co.*, *supra*, the Commission rejected a proposal which, like its decision here, would artificially treat the accrued taxes as though they were a part of the company's capitalization for the purpose of determining the fair rate of return.

In departing from *Phillips* and its unbroken line of prior decisions the Commission acted arbitrarily and capriciously. While the Commission disputes "the existence or extent of any net detriment" (Br., p. 32), we have shown above that Panhandle could have earned substantially more than 1.5 percent if it had financed its new facilities through conventional sources of capital, rather than through use of liberalized depreciation and accelerated amortization. Panhandle would not have elected to use Sections 167 and 168 except for the Commission determinations which the company sought, obtained and relied upon (R. 1757-9). It follows, therefore, that Panhandle's loss of revenues in excess of 1.5 percent is not "conjecture," as the Commission suggests (Br., p. 31). And as we have explained, and as this Court recognized in *City of Detroit* (97 App. D.C. at 272; 230 F. 2d at 822), the purported offsetting indirect benefits which the Commission

¹¹ As stated in Panhandle's brief in *Amere* (at p. 2):

"The ultimate question presented is whether the economic benefits of accelerated depreciation for tax purposes . . . shall be passed on to the customers of natural gas pipe line companies or whether those benefits shall remain with the companies."

enumerates (Resp. Br., pp. 31-32) are of small consequence for a pipeline with Panhandle's ability to attract capital.

The Commission's disregard of its prior decisions is especially arbitrary because of its retroactive character. While the Commission asserts (Br., pp. 36-37) that Opinion No. 342 was heralded by *United Fuel Gas Co., supra*, there the Commission merely referred to its observation in another proceeding that Section 167 and 168 benefits might indirectly reduce rate of return through "an actual and favorable effect on the company's cost of money * * *" (22 F.P.C. 260, 267). Similarly, despite its reservation in *Tennessee Gas Transmission Co.*, 24 F.P.C. 204, 206, *rev'd*, 293 F.2d 761, *cert. granted*, 30 L.W. 3229-30, there the Commission adopted for its interim order a position which is in all respects identical to that reached in *Phillips, supra*.

Thus, the Commission applied a changed policy, first announced on March 7, 1961, to Panhandle's tax elections and accruals made as early as 1954 (R. 1901-5). It did so even though Panhandle made its elections long ago to use Sections 167 and 168 and accumulated its tax accruals over the years in reliance upon the Commission's assurance as contained in its previous decisions which Panhandle sought and obtained, that Panhandle would be permitted to retain the full benefits of Sections 167 and 168 (R. 1757-9). The retroactive nature of the Commission's 1961 decision is further emphasized by the fact that this proceeding concerns not "rates for the future * * *" (as erroneously stated in the Commission's brief at p. 33), but "rates during the period from March 26 to July 1, 1960" (R. 3551).¹²

¹² The Michigan Commission contends as *amicus curiae* that Panhandle's tax accruals "should be included in the rate-of-return computation at zero cost interest." (Br., p. 5). Such contention is made without reference to the Congressional intent of Sections 167 and 168 (*Id.* at 10) and in disregard of *City of Detroit*, which is not even cited in its brief (see *Id.* at iii). The Michigan Commission's fundamental error is due to its erroneous belief that "accruals for deferred Federal income taxes represent capital contributed by customers * * *" (*Id.* at 5). But, as pointed out above, such funds are tantamount to "a loan not from the customer but from the government." *United Fuel Gas Co., supra*, 23 F.P.C. at 513.

CONCLUSION

For the reasons set forth above and in our Initial Brief, the Commission erred in treating Panhandle's tax accruals as though they were a part of the company's capitalization and in allowing a token rate of 1.5 percent thereon. Because of such improper and unlawful treatment of Panhandle's tax accruals, the Commission fixed an unreasonable and confiscatory over-all rate of return allowance of 6.25 percent for Panhandle instead of the fair and proper return of 6.46 percent. Accordingly, Panhandle respectfully requests this Court to reverse and set aside the Commission's Order of March 20, 1961.

Respectfully submitted,

PANHANDLE EASTERN PIPE LINE COMPANY

By /s/ HARRY S. LITTMAN
Its Attorney

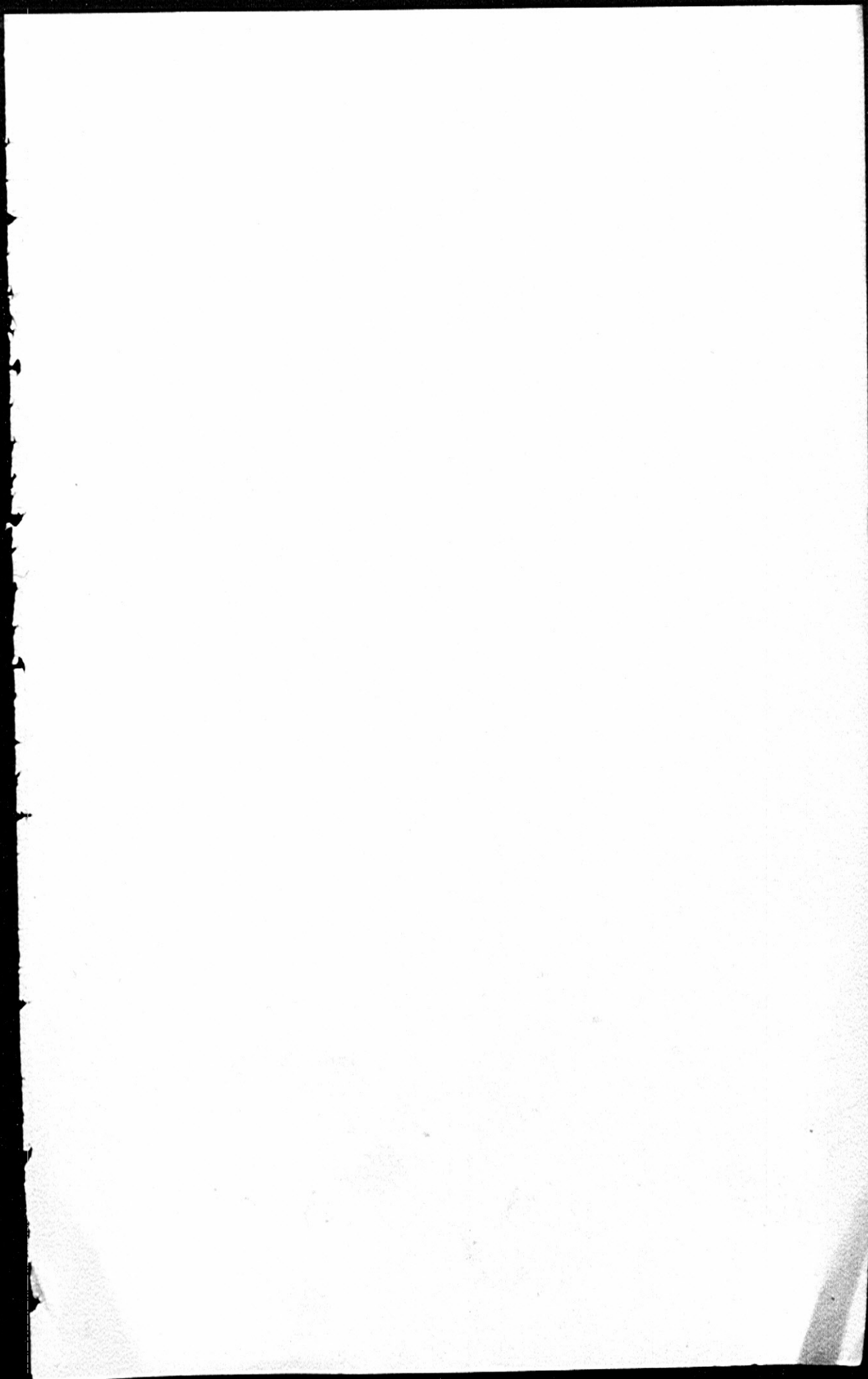
HARRY S. LITTMAN
DALE A. WRIGHT
RICHARD LITTELL
317 Wyatt Building
Washington 5, D. C.

JOSEPH J. DANIELS
Baker & Daniels
810 Fletcher Trust Building
Indianapolis 4, Indiana

ROBERT P. PATTERSON, JR.
Patterson, Belknap & Webb
1 Wall Street
New York 5, New York

*Attorneys for Panhandle Eastern
Pipe Line Company*

February 26, 1962



Comparative Balance Sheets

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APPENDIX A

Assets

	December 31,	1960	1959
PLANT, PROPERTY AND EQUIPMENT, at original cost, which does not purport to represent present day replacement or realizable values		<u>\$310,570,061</u>	<u>\$310,104,830</u>
INVESTMENTS:			
Subsidiaries not consolidated:			
Trunkline Gas Company (Note 3)		34,080,418	34,080,418
Others (Note 4)		21,836,639	6,896,099
National Distillers and Chemical Corporation - Common stock (Market value - approximately \$39,000,000)		7,482,328	7,482,328
Other		4,565,817	4,565,817
Total investments		<u>67,965,202</u>	<u>53,024,662</u>
CURRENT ASSETS:			
Cash in banks and working funds		14,968,293	9,467,269
U. S. Government securities		5,960,100	23,661,320
Accounts receivable, less reserve of \$786,883		15,481,182	14,677,380
Materials and supplies, at average cost		4,092,881	4,106,434
Prepaid accounts and special deposits		627,737	706,250
Total current assets		<u>41,130,193</u>	<u>52,618,653</u>
DEFERRED ITEMS:			
Capital stock expense		33,413	34,808
Other		186,323	657,859
Total deferred items		<u>219,736</u>	<u>692,667</u>
		<u>\$419,885,192</u>	<u>\$416,440,812</u>

(See accompanying notes to financial statements which are an integral part hereof)

(Source: Panhandle Eastern Pipe Line Company, 1960 Annual Report, pp. 22-23. Notes accompanying the financial statement are omitted).

Liabilities

	December 31,	1960	1959
CAPITAL STOCK AND SURPLUS:			
Common stock, without par value (Note 5) -			
Authorized - 10,000,000 shares; issued and outstanding - 6,765,920 shares		\$ 21,143,500	\$ 21,143,500
Paid-in and capital surplus		5,402,894	5,368,567
Earned surplus (not restricted as to dividends to the extent of \$69,456,465) (Note 1)		87,345,003	77,740,413
Total common stock and surplus		<u>113,891,397</u>	<u>104,252,480</u>
4% cumulative preferred stock, par value \$100 (Note 6) -			
Authorized - 100,692 shares; issued and outstanding - 90,692 shares		9,069,200	9,447,700
Total capital stock and surplus		<u>122,960,597</u>	<u>113,700,180</u>
LONG-TERM DEBT (Note 7)		141,044,000	150,325,000
Total capitalization		<u>264,004,597</u>	<u>264,025,180</u>
CURRENT AND ACCRUED LIABILITIES (exclusive of debt maturities due within one year - \$6,394,000):			
Accounts payable		8,567,387	6,490,397
Dividends declared and unpaid		90,692	94,957
Accrued taxes -			
State, local and miscellaneous Federal		2,306,609	2,202,386
Federal income (Note 8)		6,701,228	13,461,425
Accrued interest		711,548	757,421
Total current and accrued liabilities		<u>18,377,464</u>	<u>23,006,586</u>
DEFERRED LIABILITIES:			
Deferred Federal income taxes		11,230,324	10,756,954
Other		3,016,970	3,221,640
Total deferred liabilities		<u>14,247,294</u>	<u>13,978,594</u>
RESERVES:			
Depreciation, depletion and amortization		120,358,218	112,845,053
Injuries and damages		1,251,153	1,163,642
Total reserves		<u>121,609,371</u>	<u>114,008,695</u>
CONTRIBUTIONS IN AID OF CONSTRUCTION		1,646,466	1,421,757
CONTINGENT LIABILITIES (Notes 1 and 9)			
		<u>\$419,885,192</u>	<u>\$416,440,812</u>

(See accompanying notes to financial statements which are an integral part hereof)

CHAMBERS OF JUDICIAL SECTION 12-17-62
①

JOINT APPENDIX

IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

United States Court of Appeals
For the
District of Columbia Circuit

FILED

MAR 14 1962

No. 16,479

Joseph W. Stewart

CLERK

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

On Petition to Review an Order of the Federal
Power Commission

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IN THE
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On Petition to Review an Order of the Federal
Power Commission

JOINT APPENDIX

(77)

EXCERPTS FROM TESTIMONY AND PROCEEDINGS

77

Leslie T. Fournier

was called as a witness and, after having been duly sworn,

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was examined and testified as follows:

Direct Examination

By Mr. Littman:

Q. Will you please state your name and address? A. Leslie T. Fournier. My business address is 120 Broadway in New York City.

Q. And Mr. Fournier, what is your position with Panhandle Eastern Pipe Line Company? A. I am vice president and treasurer of the company, vice president since 1946 and treasurer since 1950. I also hold the same positions with Trunkline Gas Company, since 1953.

Q. State your education and experience? A. I was graduated in Economics from the University of British Columbia with a B.A. Degree in 1921.

In 1923 I received an M.A. Degree from the same university. And in 1927 I received a Ph.D. Degree in Economics from the University of California. I was a member of the Economics Faculty of Princeton University from 1924 to 1937, for the beginning years as an instructor, and then as an Assistant Professor. Among other subjects, I taught corporation finance, accounting and public utility regulation. I also taught the graduate course in public utility regulation in the last few years I spent at Princeton.

From 1937 to 1946 I was employed by the Securities and

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Exchange Commission in the Public Utilities Division where I was in charge of Research, and during the last four years at the Commission I was Special Assistant to

(1234)

the Commission, working principally on reorganization cases under the Public Utility Holding Company Act.

Currently, I am Chairman of the Public Service Committee of the Chamber of Commerce of the State of New York and a member of the Executive Committee of the Chamber.

Q. What are your duties as an officer of Panhandle?

A. I am responsible for the operation of the treasury department, the accounting department, and for conducting the financial operations of the company. This includes raising the funds required by the company for capital expansion, either through bank loans, or by the sale of long-term securities, the meeting of sinking fund payments, the maintenance of bank accounts, and all of the functions customarily performed by the treasury department, including the deposit of funds received from the sale of our products, the payment of all bills for services and materials, payrolls, gas purchase and royalty payments, ad valorem taxes, and the insurance and pension programs of the company.

For the past 20 years I have had continuous contact with representatives of the financial community including bankers, trust officers, security analysts, officers of

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investment trusts, investment banking specialists, the rating agencies and, in general, the representatives of a wide variety of institutional investors.

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C. F. Blanchard

was called as a witness and, having first been duly sworn, was examined and testified as follows:

Direct Examination

By Mr. McMillen:

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Q. Please state your name, address and present position.
A. C. F. Blanchard. I am a resident of Arlington County, Virginia. I am Chief of the Division of Finance and Statistics of the Federal Power Commission.

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1349

By Mr. Littman:

Q. Mr. Blanchard, start with the top part of Exhibit 39. Under Method I, you will find that the deferred taxes are zero. We assume a long-term debt at 50 per cent, having a cost of 4 per cent; giving us 2 per cent of cost for long-term debt. Then we have common equity at 50 per cent, which I shall ask you to assume, a 10 per cent return thereon, which gives 5 per cent, or a total over-all allowance of 7 per cent. Do you follow me so far? A. Yes.

Q. Now, then, let's take Method II, which is similar to the method that you have reflected in your own Exhibit 19, under similar assumptions. There you have 2 per cent—we ask you to assume that 2 per cent of the capitalization is made up of deferred Federal taxes, that you have put in at the zero cost, and therefore a zero return, right? I am just asking you to assume that it amounts to 2 per cent. A. You have put it in, I haven't.

Q. Well, you have put in \$9,960,000 worth at zero; that is what you did, isn't it? A. Yes.

Q. Well, I am simply illustrating that 2 per cent is the capitalization.

Now, if we reduce pro tanto the long-term debt and the common equity by 1 per cent, because we can't have a

1350

capitalization exceeding 100 per cent, then you would have 49 per cent long-term debt at the same rate of 4 per cent, which I mentioned a while ago. Then you would have 49 per cent of equity at 10 per cent, which would give you a

total over-all return of 6.86 per cent. Do you follow me so far? A. Yes.

Q. In other words, the effect at this point of including 2 per cent of the capitalization at zero is to reduce the rate of return that would otherwise be allowed from 7 per cent down to 6.86 per cent, under the hypotheses assumed for purposes of Exhibit 39. Isn't that right? A. Yes, but I want to emphasize that "under the hypotheses assumed."

Q. Yes, and pretty soon, I am sure you will say, as you must, that under the hypothesis you have assumed in Exhibit 19, you have cut our rate of return by a quarter per cent by this very process. But we'll get to that later.

Now, go, please, to the second part of the tabulation, the bottom part. Let's assume a rate base before adjustment of \$100,000, just for purposes of illustration. Let's assume that we deduct from the rate base \$2,000 of deferred taxes, which, as you see, represents 2 per cent of the capitalization.

Do you follow me so far? A. Yes.

1351

Q. Then we get a rate base of \$98,000, and applying thereto a rate of return of 7 per cent, we get an amount of return of \$6,860.

Do you follow so far? A. I do.

Q. Now, going to the final computation, the lower right-hand portion, using the same rate base before adjustment of \$100,000, and following the Method II, which is the method that you have used here of not deducting the deferred taxes from the rate base, you then get a rate base as adjusted of the same \$100,000 figure, do you not? A. Yes.

Q. And if you apply the 6.86 per cent to that, which is the rate of return which you have shown up above in Method II, you come out with the same return of \$6,860, as you would if you deducted the \$2,000 of deferred taxes from the rate base and used a 7 per cent return, isn't that true? A. That is true.

(1351)

Q. Now, then, the whole purpose of this, as I am sure you appreciate, is simply to calculate and show mathematically that you come out in the same place in dollars of return whether you use your method of including in the capitalization as long-term debt the deferred taxes at zero cost, or whether you deduct those deferred taxes from the rate base. You would come out to the very same place, wouldn't you?

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A. That seems to be the case, based on this hypothetical illustration.

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Leslie T. Fournier

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Further Direct Examination

By Mr. Littman:

Q. Mr. Fournier, you have previously testified in this proceeding, have you not? A. I have.

Q. Do you have before you a copy of Exhibits 44 to 51, inclusive? A. I have.

Q. Were these exhibits prepared by you or under your supervision and direction? A. They were.

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1752

By Mr. Littman:

Q. Mr. Fournier, does Exhibit 44 correctly show these data which you just described in your previous answer as of May 31, 1960, reflecting the elimination of deferred federal taxes from the capitalization? A. Yes.

Q. Will you describe Exhibit 44, please?

1753

A. This exhibit consists of two sheets, the first of which shows the total capitalization of Panhandle Eastern on May 31, 1960, which is in the middle of the period during which the G-19780 rates were in effect. The total debt outstanding as of that date excludes debt due within one year, amounting to \$4,300,000, the detail of which is shown on Sheet No. 2.

Reference again to Sheet No. 1: There is shown the ratio of debt to total capitalization, namely 54.62 percent, the average historical or imbedded cost of the debt, namely, 3.55 percent, and the resultant component in the rate of return mathematical computation, namely 1.94 percent.

The preferred stock amounted to 3.64 percent of the total capitalization issued at a cost of 3.99 percent. The return cost component of that preferred is .15 percent. The common stock and surplus of \$107,672,125 is 41.74 percent of the company's total capitalization.

The figures show that with an annual 7 percent rate of return, the common equity would be allowed to earn 11.76 percent—giving a return component of 4.91 percent. The table below the capitalization ratios shows the allowed return on the common equity where the overall rate of return is less than 7 percent. Thus, a $6\frac{3}{4}$ percent return would result in an allowed return on the common of Panhandle

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of 11.16 percent. A $6\frac{1}{2}$ percent overall rate is associated with a 10.56 percent return on the common equity, and so forth.

Sheet No. 2 lists each issue of debt outstanding on May 31, 1960, deducts the amounts due within one year, and shows the net effective interest cost of each issue and the same for the preferred stock.

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Q. Do you recall what Exhibit 39 in this case shows?

A. Yes. That exhibit demonstrates the fact that the deferred tax adjustment made by the staff which artificially reduces the cost of debt capital has exactly the same mathematical effect on the allowed return as though the staff had reduced our rate base by the amount of the deferred taxes.

Q. I note in the center of the tabulation on Exhibit 45 an item labeled "Deferred Tax" in the amount of \$11,076,954. Please state what that item consists of. A. The amount of \$11,076,954 represents deferred Federal income taxes resulting from accelerated amortization in the amount of \$6,960,095, and from liberalized depreciation in the amount of \$4,116,859.

Q. Can you give us a similar breakdown of the deferred Federal tax figure shown in Staff's Exhibit 19, of \$9,960,763 as of May 31, 1959? A. Yes. \$6,673,904 of that amount is due to accelerated amortization, and \$3,286,859 is due to liberalized depreciation.

Q. Would you give us the breakdown of the deferred Federal tax figure shown in Exhibit 40 of \$10,756,954? A. Yes. \$6,980,095 of that amount is due to accelerated amortization, and \$3,776,859 is due to liberalized depreciation.

Q. You testified a few moments ago that in your opinion

1757

the staff's treatment of deferred taxes was not proper in arriving at the fair rate of return for Panhandle. Will you please state your reasons for this conclusion? A. Yes. The \$9,960,763 item shown on Mr. Blanchard's Exhibit 19 under the classification "Deferred Federal Taxes" as of May 31, 1959, and the comparable figure of \$11,076,954 as of May 31, 1960, include deferred taxes resulting from both accelerated amortization and accelerated depreciation. From the outset—

(1758)

Q. Pardon me. Do you mean liberalized depreciation? You said accelerated amortization. It is accelerated depreciation. A. They are synonymous expressions.

From the outset, Panhandle's consistent policy has been that it would not elect to utilize these tax incentives provided by the Congress until there had been a clear determination by the Federal Power Commission that the company would be entitled to retain all of the benefits afforded.

Pursuant to that policy, Panhandle initiated, on August 14, 1952, a proceeding in Docket G-2029 for a declaratory order relating to the treatment which the Commission would apply to accelerated amortization.

Shortly afterward the Commission expanded that proceeding into a rule-making determination in Docket R-126. Panhandle participated fully in that proceeding and advised

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the Commission that it could not make the election until a satisfactory determination was made by the Commission.

Therefore, it was not until after the Commission issued its Opinion No. 264, on December 4, 1953, that Panhandle made its election to utilize accelerated amortization.

After Panhandle had made its election, the City of Detroit and the Commission's Staff attempted in our rate case at Docket G-1116 to deprive Panhandle of those tax benefits. But in Opinion No. 269 the Commission specifically held that those benefits could not be passed on either directly or indirectly to the rate payers.

This was one of the major points in the City of Detroit Case, and the Court of Appeals affirmed the Commission's action in specific terms.

The same policy was followed by Panhandle with respect to liberalized depreciation. The company advised the Federal Power Commission that it could not elect to adopt the depreciation methods provided by Section 167 of the Internal Revenue Code unless it was assured of

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retaining the full benefits available under the statute, and Panhandle participated actively in Docket G-6358, in which this issue was resolved by the Commission by Order of June 30, 1956.

Presiding Examiner: May I interrupt to inquire if that is the Amere Case, G-6358?

Mr. Littman: Yes, Mr. Examiner, that is the Amere Case.

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Presiding Examiner: Thank you.

The Witness: After our position was sustained by the Commission, we proceeded with the election to use the liberalized depreciation methods allowed by the Congress.

I wish to emphasize that the company acted on the faith of the Commission's determinations after our policy was made known to them.

Since the Commission has never changed its announced policy with regard to accelerated amortization and liberalized depreciation treatment, we cannot accede to the staff's attempt here to change the rules after we had acted in good faith in reliance upon the Commission's pronouncements.

It is clear that by including in Panhandle's capitalization these deferred Federal taxes as cost-free debt, the staff would deprive Panhandle of all the benefits stemming from the use of accelerated amortization and liberalized depreciation authorized by the Federal tax laws.

Since it is the firm belief of Panhandle and its counsel that such tax benefits belong to the company and cannot lawfully be passed along to its customers, it follows that, in our opinion, the staff's treatment of these deferred taxes is improper.

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Cross Examination (cont'd.)

By Mr. McMillen:

Q. Mr. Fournier, do you have with you the information Staff requested in its letter to Mr. Littman, dated July 22, 1960? A. I do.

Do you have a copy of that letter?

Mr. Littman: I have the original here.

The Witness: All right.

By Mr. McMillen:

Q. First, could you give me the balance in the accelerated amortization account, which I believe is Account 259, at the end of each year commencing from the date accelerated amortization was first recorded? A. Yes, sir.

Q. At the same time, if you wish, it might be most expedient to state the total debits and credits applicable for each of those periods, if any. A. During the year 1954, this account was credited in the total amount of \$2,838,718.

Q. This was the first recording? A. That was the first recording after the Commission's

1902

decision in the 1953 case on this subject.

Q. Fine. Will you continue?

Mr. Littman: Do you mean Opinion 269, or do you mean some other decision?

The Witness: No, I believe the opinion of the Commission relating to the treatment of accelerated amortization, as I testified in my last appearance here.

By Mr. McMillen:

Q. You just go ahead and give this information, please. A. In 1955, the opening balance was what I have just given you. The credits were \$1,400,000, and there were two

(1902)

debits in that account, amounting to \$11,766, and \$16,747, relating to adjustments for prior periods, leaving a closing balance of \$4,210,205.

In 1956 there was a debit of \$57,000 and a credit of \$1,176,000, and a reduction of the 1955 credit in the amount of \$45,616, leaving a closing balance at the end of '56 of \$5,283,589.

In 1957 there was a debit of \$172,000, and two credits: \$762,000, and an adjustment of the 1956 figure, which was an additional credit of \$27,404, leaving a closing balance of \$5,900,993.

In 1958 there was a debit of \$193,000, there was a credit of \$745,000, and there was an adjustment of the 1957 figure, amounting to \$3,089, which was equivalent to a debit, making

1903

a closing balance of \$6,449,904.

In 1959 there was a debit of \$193,000, there was a credit of \$731,000, there was an additional credit of \$7,303, \$2,175, \$2,580; and downward adjustments, which were in the nature of debits, amounting to \$12,346, and \$752, and \$9,084; there were additional debits amounting to \$735.

Mr. Littman: Wasn't that a negative debit?

The Witness: I don't understand what a negative debit is.

Mr. Littman: Well, it is a red figure, anyway.

The Witness: Yes.

May I make a suggestion at this point? These figures for 1959 and 1960 become a little bit complicated, because you are beginning to get charge-offs, you see. I would think that it would mean more to the Staff, insofar as the detail is concerned, if I just furnish you with a copy of this document, which I am very glad to do. And if I confine myself at this point to completing the year-end balances. I will do it the other way, if you wish.

(1905)

By Mr. McMillen:

Q. I prefer that you go ahead and read it into the record. A. Put it into the record, thank you. I am afraid I have got it confused now.

Q. The \$735 was an additional debit you gave.

1904

A. Yes, but it is a negative debit, it is a red figure on the debit side.

Mr. Littman: It is a credit.

The Witness: I have been interpreting it as a credit as I go along. I think it is much easier to understand these figures if you will let me place my interpretation on them as I read them.

Going back to \$735, that I would call a credit; \$727, debit; \$827, credit; \$167, credit; \$1,313, credit; and I believe that completes the figures for 1959.

The closing balance in the year 1959 is \$6,980,095.

Now, in the year 1960 the opening balance, of course, is the figure I have just given you. Then for each month from January through June there is a debit of \$25,000, the same debit each month. For each month in 1960 through June there is a credit of \$21,000, leaving a closing balance which declines exactly \$4,000 a month. So that at the end of May, the figure that I gave in my testimony on rebuttal, the figure is \$6,960,095. And at the end of June it is \$4,000 less than that figure.

Q. Mr. Fournier, could you provide the same data with respect to the liberalized depreciation account? A. Yes, sir. The first entry occurred in 1956 as a credit of \$691,000. In that same year there were two additional credits applicable to the years 1954 and 1955, respec-

1905

tively, namely, \$254,236, \$494,332, leaving a closing balance of \$1,439,568. In 1957 there was a credit of \$762,000, and

(1905)

a negative credit relating to an adjustment for 1956 of \$41,502, leaving a balance of \$2,160,066.

In the year 1958 there was a credit of \$786,000 and a negative credit of \$9,207, leaving a balance of \$2,936,859.

I am glad to say that the figures for 1959 are not complicated.

In 1959 there was a credit of \$340,000, leaving a closing balance of \$3,776,859.

In 1960 there was a monthly credit of \$68,000, leaving a closing balance at the end of May of \$4,116,859.

Q. And 1956 was the first year in which liberalized depreciation was recorded; is that correct? A. That is correct.

Q. I thank you.

• • • • •

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Exhibit No. 39

Docket No. G-19780

DEMONSTRATION OF EFFECT OF INCLUSION OF ACCUMULATED DEFERRED TAXES IN
THE COST OF CAPITAL CALCULATION

	Method I			Method II	
Deferred Federal Taxes	0	0	0	2% at 0% = 0	
Long Term Debt	50% at 4% = 2.00%			49% at 4% = 1.96%	
Common Equity	50% at 10% = 5.00%			49% at 10% = 4.90%	
Total			7.00%		6.86%
Rate Base, before adjustment	\$100,000			\$100,000	
Less Deferred Taxes	2,000			0	
Rate Base Adjusted	\$ 98,000			\$100,000	
Rate of Return	7%			6.86%	
Amount of Return	\$ 6,860			\$ 6,860	

(2498)

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Exhibit No. 44

Schedule 1,
Docket No. G-19780
Witness: L. T. Fournier

PANHANDLE EASTERN PIPE LINE COMPANY
CAPITALIZATION AND CAPITAL RATIOS
As of May 31, 1960

	Amount	% of Total Capitalization	Rate	Cost/ Return
Long Term Debt (Excludes debt due within one year)	\$140,878,000	54.62%	3.55%	1.94%
Preferred Stock	9,377,700	3.64	3.99	.15
Common Stock & Surplus	107,672,125	41.74	11.76	4.91
Total	<u>\$257,927,825</u>	<u>100.00%</u>		<u>7.00%</u>

Allowed Return	Allowance for Stockholders Equity
6.00%	9.37%
6.25	9.97
6.50	10.56
6.75	11.16
7.00	11.76

2498

PANHANDLE EASTERN PIPE LINE COMPANY
LONG TERM DEBT AND PREFERRED STOCK CAPITAL
May 31, 1960

Schedule 2.
Docket No.: G-19870
Witness:—L. T. Fournier

	Balance Outstanding	Amounts Due Within One Year	Long Term Portion	Net Effective Interest Rate
LONG TERM DEBT AT MAY 31, 1960				
Serial Debentures Due 1947-1971	\$ 22,000,000	\$2,000,000	\$ 20,000,000	2.57%
3¼% Sinking Fund Debentures Due 1973	17,625,000		17,625,000	3.31
Serial Debentures Due 1953-1962	4,500,000	1,500,000	3,000,000	2.52
2¾% Debentures Due 1975	20,000,000		20,000,000	2.88
3¼% Debentures Due 1971	11,999,000		11,999,000	3.43
3¼% Debentures Due 1974	29,054,000		29,054,000	3.27
4¼% Debentures Due 1978	40,000,000	800,000	39,200,000	4.82
Total Long Term Debt	<u>\$145,178,000</u>	<u>\$4,300,000</u>	<u>\$140,878,000</u>	<u>3.55%</u>
PREFERRED STOCK AT MAY 31, 1960				
4% Cumulative Preferred Stock	<u>\$ 9,377,700</u>	<u>\$</u>	<u>\$ 9,377,700</u>	<u>3.99%</u>

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman;
Frederick Stueck, Arthur Kline and Paul A. Sweeney.

Docket No. G-19780

PANHANDLE EASTERN PIPE LINE COMPANY

Order Determining Rate of Return. Disallowing Proposed Increased Rates. Directing Payment of Refunds. and Permitting Substitution of Lower Interim Rates

(Issued March 20, 1961)

On September 10, 1959, Panhandle Eastern Pipe Line Company filed proposed rates, reflecting an increase of \$8,653,700 in its effective rates. These increased rates were suspended, by order issued October 23, 1959, until March 26, 1960, when they were permitted to become effective subject to refund. Hearings were held at various times from January to August, 1960. By order issued herein on September 1, 1960, the Commission limited the issues in this phase of the proceeding to rate of return and related income taxes and omitted the intermediate decision. Oral argument was heard on November 18, 1960. Since rates reflecting further increases, filed by Panhandle in Docket No. RP60-8, were permitted to become effective July 1, 1960, this proceeding concerns Panhandle's rates during the period from March 26 to July 1, 1960.

Since Panhandle's costs of long-term debt and preferred stock are not in dispute, the calculation of the over-all rate of return to be applied to Panhandle's net investment rate base requires only the determination of the appropriate return to be attributed to Panhandle's accumulated deferred taxes and to its equity capital. In Opinion No. 342, *Northern Natural Gas Co.*, FPC, Docket No.

G-19040, March 7, 1961, it was determined that a factual statement of a pipeline company's capital should include the amounts accumulated in the restricted account for deferred taxes, and that a net return of 1.5 percent should be attributed to such amounts. The principles applied in the *Northern* case are equally applicable to Panhandle in the present case. See also, Opinion No. 343, *Kansas-Nebraska Natural Gas Co.*, FPC, Docket No. G-12391, March 8, 1961.

Extensive evidence of the past earnings experience and market position of Panhandle and comparable enterprises was presented as a guide to the determination of the return on equity presently required to enable

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Panhandle to attract sufficient equity capital. This data, which includes earnings-price ratios and return on book value of equity, indicates that Panhandle has been and continues to be one of the strongest of the major pipelines. Panhandle's stock has steadily advanced in price, and its recent earnings per share have been such as to allow the company to pay out only 54 percent of net earnings and yet maintain a dividend rate as high as most of the other pipelines. Although a substantial portion of its retained earnings are subject to possible refunds in pending rate cases, Panhandle's financial record has generally been favorable and it demonstrates the continuing strength of the company's business position.

In recent cases, in which similar evidence of market conditions and the financial experience of the individual pipeline companies was considered, we have allowed rates of return on equity of 10.12,¹ 10.18,² 10.5,³ and 10.8 percent.⁴

¹ *Tennessee Gas Transmission Co.*, ... FPC, Docket No. G-19983, August 9, 1960.

² *Southern Natural Gas Co.*, 24 FPC 26, Docket No. G-20509, July 8, 1960.

³ *Northern Natural Gas Co.*, *supra*.

⁴ *Kansas-Nebraska Natural Gas Co.*, *supra*.

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These figures reflect in part our estimate of the particular needs of the individual company, and at the same time they represent our judgment as to the general level of earnings required to enable the pipeline industry to attract equity capital in the contemporary market. Thus, the 11.76 percent return on equity claimed by Panhandle herein appears to us to be unnecessarily high at the present time. Upon consideration of the whole record, and particularly the factors mentioned above, we conclude that a return of 10.47 percent on Panhandle's equity will maintain Panhandle's financial integrity and will be sufficient to attract the new capital needed for expansion.

Based on the foregoing determinations, the fair and reasonable over-all rate of return for Panhandle is 6.25 percent, calculated as follows, based on Panhandle's capitalization as of May 31, 1960:

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	Amount	Ratio	Cost	Return
Long-term debt	\$140,878,000	52.37 x	3.55	1.86
Preferred stock	9,377,700	3.49 x	3.99	.14
Accumulated deferred taxes on income	11,076,954	4.12 x	1.50	.06
Common equity	107,672,125	40.02 x	10.47	4.19
	<u>\$269,004,779</u>		Over-all return:	<u>6.25</u>

The over-all rate of return so determined is applicable to Panhandle's transmission properties. Questions with regard to Panhandle's own production will be decided in the later phase of this proceeding. Panhandle's proposed increased rates filed herein should be disallowed, and Panhandle permitted to file substitute rates reflecting a 6.25 percent rate of return. Panhandle should be required to make immediate refunds, with interest, of the increased rates collected from March 26 to July 1, 1960, to the extent that such rates exceed the substitute rates based on a 6.25 percent rate of return.

The Commission finds:

(1) The fair, and just and reasonable rate of return to be allowed Panhandle is 6.25 percent; subject, however, to final disposition in the next phase of this proceeding of the remaining issues herein, and to such further order as may be justified in light of the disposition of such remaining issues.

(2) The proposed increased rates filed by Panhandle herein are excessive and should be disallowed.

(3) Panhandle should be permitted to file herein substitute lower rates satisfactory to the Commission, based on the 6.25 percent rate of return herein found to be proper for the purpose of this interim order, such substitute lower rates to become effective as of March 26, 1960, upon acceptance by the Commission, subject to refund in accordance with the Commission's order of March 25, 1960, and the undertaking heretofore filed by Panhandle in accordance with the terms of that order.

(4) Panhandle should be required to make prompt refunds with interest at 7 percent, in accordance with the Commission's order of March 25, 1960, and the undertaking heretofore filed by Panhandle, of all amounts collected by it from its jurisdictional customers subject to refund under its proposed increased rates; provided, however, that if Panhandle files substitute

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lower rates as herein provided, the amount of such refunds should be the excess of the amounts so collected over what it would have collected on the basis of the substitute lower rates so filed and found to be satisfactory by the Commission. A plan for making such refunds should be submitted for approval of the Commission.

(3554)

The Commission orders:

(A) The proposed increased rates filed in this proceeding by Panhandle are hereby disallowed.

(B) Panhandle may, within 45 days of the date of this order, file in lieu thereof appropriate substitute tariff sheets to its FPC Gas Tariffs containing lower rates satisfactory to the Commission, based on the 6.25 percent rate of return on transmission facilities herein found to be proper for the purpose of this interim order. Panhandle shall accompany its substitute filing with supporting cost of service and allocation data, to be computed and presented in the same form and manner as contained in its exhibits heretofore offered by it in this proceeding, revised only to reflect a 6.25 percent rate of return and Federal income taxes associated therewith. Panhandle shall further furnish with its filing a statement setting forth the method of computation of such substitute rates and showing the derivation thereof. Panhandle shall also accompany its substitute tariff sheets and supporting data with a certificate showing service of copies thereof on all purchasers under the rate schedules involved, interveners in this proceeding, and interested state commissions. Comments by such parties shall be submitted to the Commission within ten days after service by Panhandle as required herein.

(C) Upon acceptance of such filing of substitute rates as satisfactory to the Commission, the rates, charges and classifications set forth in Panhandle's substitute tariff sheets shall become effective as of March 26, 1960, subject to refund, in accordance with the Commission's order of March 25, 1960, and the undertaking heretofore filed by Panhandle in compliance with the terms of that order, and subject to further orders of the Commission in this proceeding.

(D) Panhandle shall, within 45 days of the date of this order, file with the Commission its plan for promptly

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refunding to its jurisdictional customers the amounts which, by finding paragraph (4) of this order, the Commission has found should be refunded. Panhandle shall accompany its plan for refunds with a statement setting forth the computation of the refunds and interest, and the derivation thereof. Panhandle

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shall also accompany its plan for refunds and supporting statement with a certificate showing service of copies thereof on all purchasers under the rate schedules involved, interveners in this proceeding, and interested state commissions. Comments by such parties shall be submitted to the Commission within ten days after service by Panhandle as required herein. Upon approval by the Commission of said plan of refunding Panhandle shall make the refunds as so approved within 30 days thereafter, and shall report to the Commission within said 30 days the amounts so refunded to each jurisdictional customer.

(E) This order is without prejudice to further hearings in this proceeding on the issues not herein decided and to such further order or orders as the Commission may issue in the disposition of this proceeding.

By the Commission.

Chairman Kuykendall concurs but adheres to his views on liberalized depreciation as expressed in his dissenting opinion accompanying Opinion No. 342 issued in *Northern Natural Gas Company, et al.*, Docket Nos. G-19040, *et al.*

J. H. GUTRIDE
Joseph H. Gutride,
Secretary.

(3556)

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UNITED STATES OF AMERICA
BEFORE THE FEDERAL POWER COMMISSION

Docket No. G-19780

In the Matter of

PANHANDLE EASTERN PIPE LINE COMPANY

**Application of Panhandle Eastern Pipe Line Company for
Rehearing of Order Issued March 20, 1961**

Panhandle Eastern Pipe Line Company (Panhandle), being aggrieved by the Commission's "Order Determining Rate of Return, Disallowing Proposed Increased Rates, Directing Payment of Refunds, and Permitting Substitution of Lower Interim Rates" issued in the above-captioned proceeding on March 20, 1961, hereby applies, pursuant to Section 19 of the Natural Gas Act and Section 134 of the Commission's Rules of Practice and Procedure, for rehearing of that order on the grounds set forth below.

I

The Commission concluded, in the order here involved (at page 1), that "a factual statement of a pipeline company's capital should include the amounts accumulated in the restricted account for deferred taxes, and that a net return of 1.5 percent should be attributed to such amounts." Such conclusion is erroneous in fact and law, not supported by substantial evidence, and not supported by adequate findings. Such determination is clearly contrary to the intent of Congress and past decisions of the Commission and the courts, is beyond the authority of the Commission, deprives Panhandle of property contrary to law and without due process of law, and constitutes discriminatory and arbitrary and capricious action against Panhandle.

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Pursuant to Panhandle's consistent policy that it would not elect to utilize tax incentives provided by Congress

until there was a clear determination by the Commission that the company would be permitted to retain all of the benefits provided thereby, Panhandle initiated, on August 14, 1952, a proceeding at Docket G-2029 for a declaratory order relating to the treatment which the Commission would apply to accelerated amortization under what is now Section 168 of the Internal Revenue Code (Tr. 1757). Shortly thereafter, the Commission expanded that proceeding into a rule-making determination in Docket R-126, in which Panhandle fully participated and announced that it would not make the election until a satisfactory determination was made by the Commission (Tr. 1757-58). Therefore, it was not until after the Commission issued its Opinion 264 in that docket,¹ on December 4, 1953, enunciating the general principle that the benefits resulting from accelerated amortization should be retained by the taxpayer rather than passed on to the ratepayers, that Panhandle made its election to utilize accelerated amortization (Tr. 1758).

After Panhandle made such election, the Commission's Staff and the City of Detroit attempted in Panhandle's rate case in Docket G-1116 to deprive Panhandle of the benefits of accelerated amortization. But the Commission specifically held that such benefits could not be passed on, either directly or indirectly to the ratepayers (Opinion 269, 13 F.P.C. 53, 81-4).

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The City of Detroit sought a review of this ruling in the U. S. Court of Appeals for the District of Columbia Circuit.² The Court upheld the Commission in this regard.

¹ *In the Matter of Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 F.P.C. 369.

² *City of Detroit v. Federal Power Commission*, 230 F. 2d 810 (cert. denied 352 U.S. 829).

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In so doing the Court stated (at 230 F. 2d, p. 822) that the Commission had correctly concluded that:

" * * the intent of Congress reflected in Section 124A is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities. Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of the deferred taxes to accrue after the five year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from section 124A (footnote omitted). This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress."*³

The benefits arising from the use of liberalized depreciation in computing taxes have a similar history. Panhandle likewise advised the Commission that it could not elect to adopt the depreciation methods provided by Section 167 of the Internal Revenue Code unless it was assured of retaining the full benefits available under

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the Statute, and Panhandle actively participated in the *Amere* case at Docket G-6358⁴ in which the Commission

³ Emphasis is supplied throughout this application for rehearing unless otherwise indicated.

⁴ *Amere Gas Utilities Company, et al.*, 15 F.P.C. 781.

determined that liberalized depreciation should be accorded the same treatment as accelerated amortization in the Commission's Opinion No. 269, *supra*, and the Court's decision in *City of Detroit, supra* (Tr. 1758). After its position was sustained in that case, Panhandle proceeded with its election to use the liberalized depreciation methods approved by Congress (Tr. 1759).

Thereafter, in the *El Paso* case (Opinion 326) issued on August 10, 1959,⁵ the Commission stated (22 F.P.C. at p. 266):

"* * * As the United States Court of Appeals noted in the *City of Detroit* case (footnote omitted) with respect to the account for accumulated deferred taxes created in connection with accelerated amortization, *the intent of Congress was not to benefit consumers, but to encourage construction*. The Court said the solution of this Commission, which called on the consumers to pay 'normalized' taxes while crediting the difference between actual taxes and normalized taxes to an account for accumulated deferred taxes, does not result in higher rates to the consumer; it simply does not reduce them. *We concluded in the Amere case that we could not strike down an Act of Congress and we must apply Section 167 to the natural gas companies*. As stated in our order we would call the situation to the attention of Congress by transmitting copies of the presiding examiner's decision and our order to the Chairman of the Finance Committee of the Senate and the Chairman of the Ways and Means Committee of the House, and we did so by our letter dated July 2, 1956. *Since that time Congress has not amended the Internal Revenue Code or the Natural Gas Act in this respect, thus affirming our interpretation of its intentions*.

⁵ *El Paso Natural Gas Company*, Docket G-4769, 22 F.P.C. 260.

⁶ The Court of Appeals for the Fifth Circuit affirmed the Commission's action in the *El Paso* case regarding tax deferrals resulting from liberalized depreciation. *El Paso Natural Gas Co. v. F.P.C.*, 281 F. 2d 567 (5th Cir. 1960).

In the *United Fuel Gas Company* case (Opinion 334) issued January 22, 1960,⁷ the Commission reaffirmed its decision in the *Amere* and *El Paso* cases. On rehearing, the Commission maintained the same position and stated in Opinion 334-A (23 F.P.C. at p. 513):

“• • • The question of rate of return is, it is true, a matter for our discretion, and rate of return should be adjusted for the tax benefits that produce a saving, that is percentage depletion and the intangibles, but it should not be adjusted for the benefits of liberalized depreciation, (footnote omitted) which does not produce a tax saving except under certain assumptions as to future events. The customer is not injured by liberalized depreciation; it pays a rate as though this tax incentive did not exist. • • •”

In the *City of Detroit* case, the Court flatly rejected a proposal to deprive Panhandle of the benefits of accelerated amortization by deducting the entire amount of the deferred taxes from the rate base. In Opinion No. 338 in *Re Phillips Petroleum Company*, 24 F.P.C., the Commission again made plain that the benefits resulting from the use of accelerated amortization were intended for and should be retained by the taxpayer and not passed on to the ratepayers, either directly or indirectly. Thus, the Commission there stated (at *mimeo.*, p. 43):

“There was no dispute about these figures, but the Staff contended that Phillips' actual debt ratio and actual cost of debt should be adjusted to reflect as an interest-free loan an item of deferred Federal income tax liability in the amount of \$19,162,355, arising from the accelerated amortization provisions of Section 168 of the Internal Revenue Code. This would decrease Phillips' cost of debt to 2.76 percent. The examiner refused to make this adjustment, and we agree. The accelerated amortization provisions were to benefit the taxpayer, not the consumers.

⁷ *United Fuel Gas Company*, Docket G-2451 and G-5475, 23 F.P.C. 127.

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They represent an advantage bestowed by Congress to encourage the construction of emergency facilities, and we are not authorized to take away this advantage. *City of Detroit v. F.P.C.*, 230 F. 2d 810, 822 (CA DC), *certiorari* denied, 352 U.S. 829. We cannot agree to the exception made by the Michigan Public Service Commission on this point.”⁸

It is obvious that by including the accrued deferred taxes in the capitalization at an arbitrary cost of only 1.5 percent, the Commission is depriving Panhandle of substantially all of the benefits of liberalized depreciation and accelerated amortization. The Commission's treatment here produces the same result as deducting approximately 77% of the deferred tax accruals from the rate base and, thus, differs only in degree from the proposal held unlawful by the *City of Detroit* case of deducting 100% of such accruals from the rate base. Such result is clearly contrary to the intent of Congress in Sections 167 and 168 of the Internal Revenue Code, and to the decisions of the Commission, affirmed by the courts, holding that the benefits of such tax deferrals were intended for the taxpayer and should not be passed on to the ratepayer, either directly or indirectly. Moreover, the Commission's treatment of deferred tax accruals frustrates the congressional purpose of providing an incentive to American industry, including

⁸ The Commission thus affirmed the Presiding Examiner's conclusion on this point that (Decision, mimeo., p. 216, Dockets G-1148, et al.):

“It is concluded that the instant Staff proposal to treat the deferred Federal income tax item as an interest-free loan in computing Phillips' debt capitalization is subject to criticism on the same basis—i.e., that it constitutes a device designed to pass on to the rate payers a portion of the tax savings which both the Commission and the Court of Appeals in the *City of Detroit* case have held was intended by Congress to inure to the benefit of the certificate holder. . . .”

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the natural gas pipeline industry, to expand, with resulting growth of the economy. The order here involved is, therefore, clearly discriminatory, arbitrary, capricious and beyond the authority of the Commission.

The arbitrary and capricious nature of the Commission's action is emphasized by the fact, clearly shown by the record in this proceeding, that in electing to use the liberalized depreciation and accelerated amortization methods allowed by Congress, Panhandle relied in good faith upon the Commission's determinations that Panhandle would be permitted to obtain the benefits thereof.⁹ Since those decisions have been judicially affirmed, the Commission's present effort to depart therefrom and to apply a different determination retroactively constitutes a gross abuse of discretion and is clearly beyond the power of the Commission.

Moreover, the Commission's conclusion as to treatment of deferred tax accruals is not supported by any evidence in the record or by any findings, and is thus unlawful (See Administrative Procedure Act). While the Commission erroneously seeks to support its order here by reference to Opinion No. 342, in *Re Northern Natural Gas Company* and Opinion No. 343, in *Re Kansas-Nebraska Natural Gas Company*, the findings therein on this subject (Opinion No. 342, *mimeo.*, pages 3-12,

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and Opinion No. 343, *mimeo.*, page 4) are erroneous in fact and law, are not supported by substantial evidence in this record, and do not provide a lawful basis for the Commission's determination to deprive Panhandle of substantially all of the benefits of accelerated amortization and

⁹ That certain other administrative agencies or courts may have arrived at a different decision is thus immaterial and provides no lawful basis for the Commission's action in this proceeding.

liberalized depreciation in order to pass such benefits on to the ratepayer.

The very nature of the benefits for the taxpayer intended by Congress in adopting Sections 167 and 168 of the Internal Revenue Code requires that Panhandle be permitted to invest such funds while temporarily available as a result of tax deferral and to earn a full return thereon, including allowance for income taxes. The ratepayer, of course, is required to pay a fair return plus associated income taxes on the facilities devoted to his benefit. To permit Panhandle to use the deferred tax funds for income-producing purposes pursuant to the *City of Detroit* case and the intent of Congress will not result in higher rates to the consumer or penalize the ratepayer. It is completely erroneous, unfair, unrealistic and unsupported by the record to assume that the facilities constructed by the utilization of deferred tax accruals would be financed solely by means of debt capital if the tax accruals were unavailable. The Commission could as well have concluded that facilities constructed with deferred tax accruals, in the absence of such accruals, would be financed entirely by common equity.¹⁰ There is, therefore, no basis in fact or in law, for a

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suggestion that use of deferred tax accruals as a means of financing results in a higher total cost to the ratepayer for return and associated income taxes.

Assuming, *arguendo*, that it is lawful and proper to deprive Panhandle of part of the benefits of accelerated amortization and liberalized depreciation, the minimum return which Panhandle should be permitted to receive on the deferred tax accruals is 5.45 percent. The table set forth on Appendix A hereto conclusively demonstrates

¹⁰ The Commission's Order No. 203 recognizes that deferred tax accruals are more nearly equity capital than debt. 19 F.P.C. 826.

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that a return of 5.45 percent on Panhandle's deferred tax accruals results in precisely the same annual cost to the ratepayer as would obtain if Panhandle had not elected to take advantage of liberalized depreciation and accelerated amortization but had raised the same amount of capital by the issuance of debt, preferred stock, and common equity in the same proportions and at the same costs and return as the company's existing capitalization.

II

The Commission's allowance of the over-all rate of return of 6.25 percent for Panhandle is erroneous, unsupported by the evidence, and unlawful. If the Commission's determination of the over-all rate of return for Panhandle were properly corrected so as to permit Panhandle to retain all of the benefits of accelerated amortization and liberalized depreciation as intended by Congress, by the elimination of the deferred tax accruals from Panhandle's capitalization, the resulting over-all return would be 6.46 percent, as calculated

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below.¹¹ Accordingly, the Commission erred in failing to allow to Panhandle a return of at least 6.46 percent. If the Commission's determination of the rate of return were revised only to reflect the minimum return of 5.45 percent on the deferred tax accruals, as developed earlier herein,

¹¹	Amount	Ratio	Cost	Return
Long-term debt	\$140,878,000	54.62%	3.55	1.94
Preferred stock	9,377,700	3.64%	3.99	.15
Common Equity	107,672,125	41.74%	10.47	4.37
Over-all Return				6.46%

the resulting over-all return for Panhandle would be 6.41 percent, as calculated below.¹²

III

The Commission further erred in concluding (at pages 3-4) that Panhandle's proposed rates in this proceeding are excessive and should be disallowed, that Panhandle should file substitute lower rates, and that Panhandle should be required to make refunds. The Commission likewise erred in its actions (at pages 4-5) in disallowing Panhandle's proposed rates, directing the filing of substitute lower rates,¹³ and ordering that Panhandle make refunds. Such conclusions and actions

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are not supported by necessary findings, are contrary to the record, arbitrary and capricious, and unlawful. Panhandle's cost of service, even if revised to reflect the Commission's over-all return of 6¼ percent, exceeds the revenues yielded by the rates filed in this proceeding. This controlling fact is admitted by the Commission's Press Release No. 11,386 relating to the very order here involved.

WHEREFORE, in view of all the foregoing, it is respectfully requested that the Commission grant rehearing of

¹²	Amount	Ratio	Cost	Return
Long-term debt	\$140,878,000	52.37%	3.55	1.86
Preferred stock	9,377,700	3.49%	3.99	.14
Deferred taxes	11,076,954	4.12%	5.45	.22
Common	107,672,125	40.02%	10.47	4.19
Over-all Return				6.41%

¹³ The filing of lower substitute rates would serve no useful purpose in view of the fact that the rates proposed in this proceeding were superseded by the rates made effective July 1, 1960, by the Commission's order of July 8, 1960, in Docket No. RP60-8.

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its order issued March 20, 1961, and modify such order as requested herein.

Respectfully submitted,

PANHANDLE EASTERN PIPE LINE COMPANY
By /s/ HARRY S. LITTMAN
Its Attorney

Harry S. Littman
Dale A. Wright
317 Wyatt Building
Washington 5, D. C.
*Attorneys for Panhandle Eastern
Pipe Line Company*

April 19, 1961

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District of Columbia : ss

Harry S. Littman, being first duly sworn according to law, says that he is an attorney for Panhandle Eastern Pipe Line Company; that he has read the foregoing Application of Panhandle Eastern Pipe Line Company for Re-hearing of Order Issued March 20, 1961 and is familiar with the contents thereof; that he has executed the same for and on behalf of said company with full power and authority so to do; and that the facts set forth therein are true and correct to the best of his knowledge, information and belief.

/s/ HARRY S. LITTMAN

Subscribed and sworn to before me, a Notary Public in and for the District of Columbia, this 19th day of April, 1961.

/s/ LOUISE H. PARMER
Notary Public

My Commission Expires:
February 28, 1965

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APPENDIX A

PANHANDLE EASTERN PIPE LINE COMPANY
DOCKET No. G-19780Computation of Over-All Return on
Capital Equal to Deferred Taxes Based
on Capitalization at May 31, 1960

	Amount	Ratio	Cost	Return
Long Term Debt	\$ 6,050,232	54.62	3.55	1.94%
Preferred Stock	403,201	3.64	3.99	.15
Common Equity	4,623,521	41.74	10.47	4.37
Total	\$11,076,954			6.46%
Computation of Total Return and Income Taxes on Above				
Return (6.46% x \$11,076,954)				\$ 715,600
Federal Income Tax				
Return as above			\$715,600	
Less Interest (\$6,050,232 x 3.55)			214,800	
Taxable Return			500,800	
Tax at 108.333%				542,500
Total Return and Income Tax				\$1,258,100
Computation Showing Identical Total				
Return and Income Taxes By Using				
5.45% Return on Deferred Tax Accruals				
Return (5.452% x \$11,076,954)				603,900
Federal Income Tax (at 108.333%)				654,200
Total Return and Income Tax				\$1,258,100

Note: Reduction in working capital based on federal income tax accruals and changes in state income taxes have been excluded because their effect on these calculations is insignificant.

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman;
Frederick Stueck and Arthur Kline.

PANHANDLE EASTERN PIPE LINE COMPANY

Docket No. G-19780

Order Denying Application for Rehearing

(Issued May 15, 1961)

Panhandle Eastern Pipe Line Company has timely filed application for rehearing of the Commission's order, issued March 20, 1961, in the above-entitled proceedings.

The Commission finds:

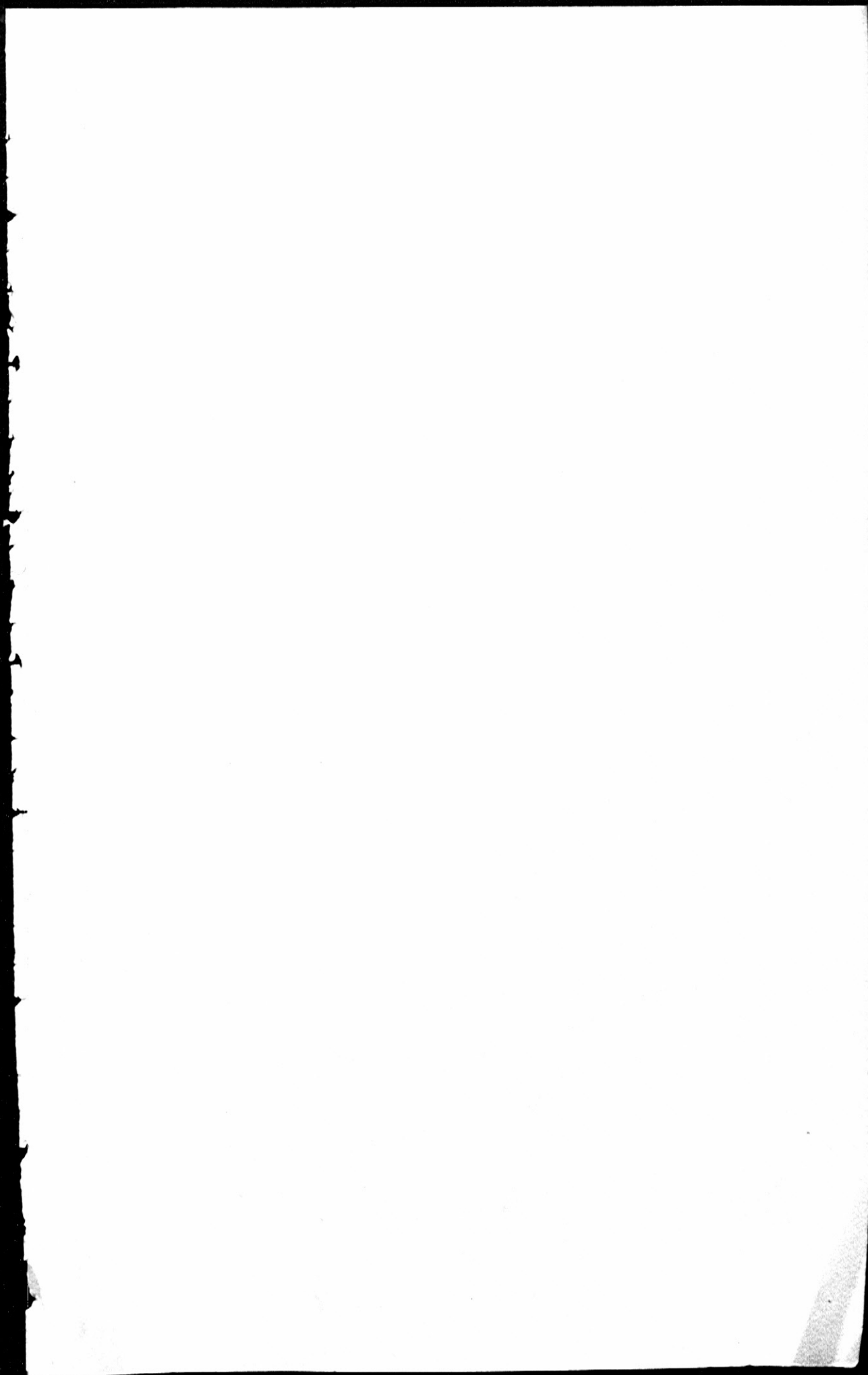
The assignments of error and grounds for rehearing set forth in the application for rehearing present no facts or principles of law which were not considered by the Commission when it issued its order herein on March 20, 1961, or which having now been considered warrant any change or modification of the said order.

The Commission orders:

The application for rehearing filed in the above-entitled proceedings is hereby denied.

By the Commission.

J. H. GUTRIDE
Joseph H. Gutride
Secretary.



PETITIONER'S ANSWER TO RESPONDENT'S
PETITION FOR REHEARING EN BANC

IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

On Petition to Review an Order of the Federal
Power Commission

#4389, 305 F2d 763

Decided 6/30/62

HARRY S. LITTMAN
DALE A. WRIGHT
RICHARD LITTELL
MELVIN RICHTER
317 Wyatt Building
Washington 5, D. C.

JOSEPH J. DANIELS
BAKER & DANIELS
810 Fletcher Trust Building
Indianapolis 4, Indiana

ROBERT P. PATTERSON, JR.
PATTERSON, BELKNAP & WEBB
1 Wall Street
New York 5, N. Y.

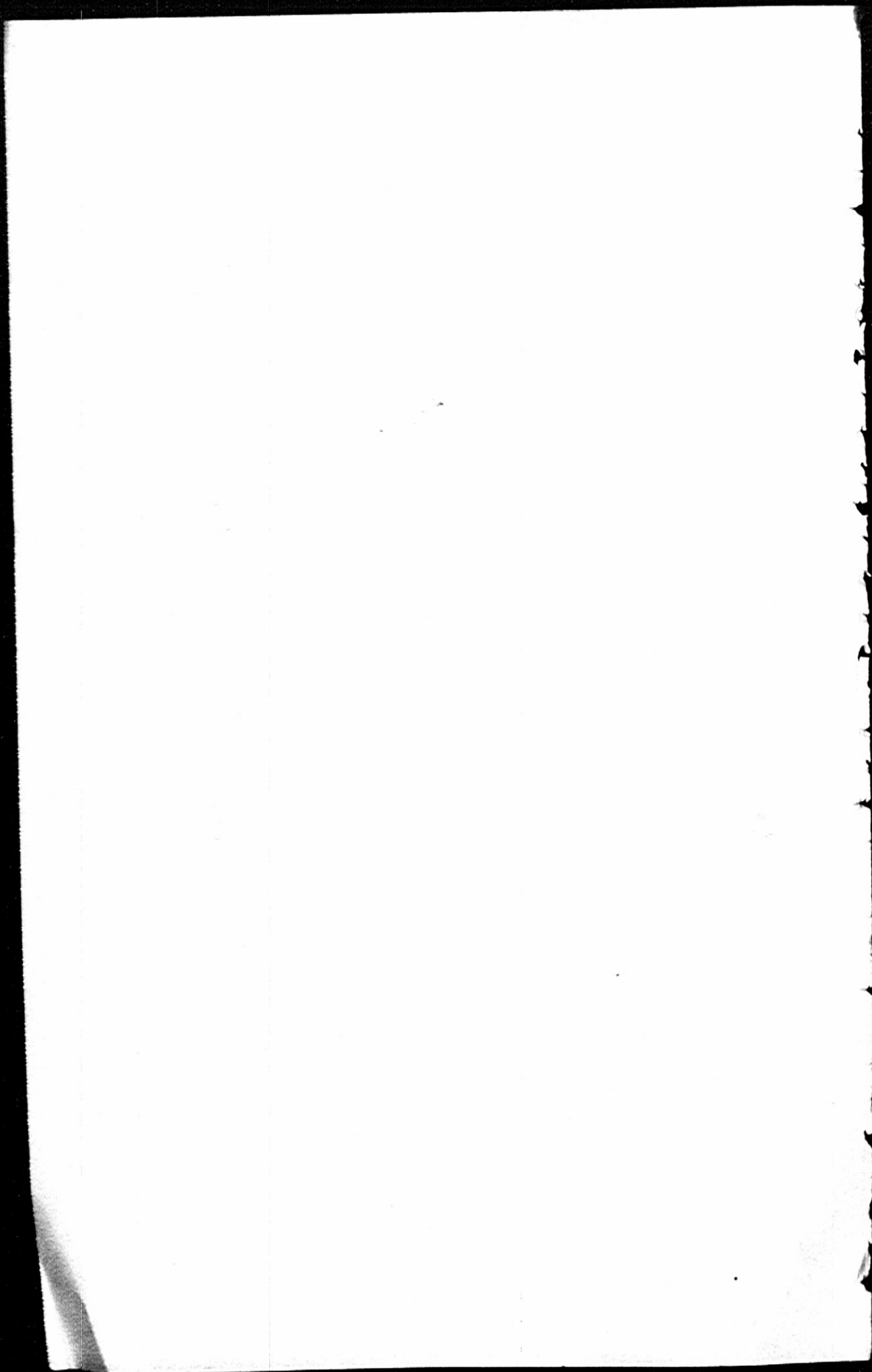
*Attorneys for Petitioner,
Panhandle Eastern Pipe Line Company*

October 22, 1962

Printed at 2700 S. Avenue, Washington, D. C.

FILED OCT 24 1962

Joseph W. Stewart
CLERK



IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

On Petition to Review an Order of the Federal
Power Commission

**ANSWER OF PANHANDLE EASTERN PIPE LINE
COMPANY TO PETITION FOR REHEARING
EN BANC**

In its Petition for Rehearing, the Commission contends, in essence, that (1) the Court erred in holding that *City of Detroit v. F.P.C.*, 97 App. D.C. 260, 230 F. 2d 810 (1955), *cert. denied*, 352 U.S. 829 (1956), required that the Commission's order here under review be set aside; and (2) accepting, *arguendo*, the Court's conclusion that upholding the Commission's order would require overruling *City of Detroit*, the Court *en banc* should nevertheless grant rehearing and proceed to overrule *City of*

Detroit. We respectfully submit that there is no merit to the Commission's position and that, accordingly, its Petition should be denied.¹

I

**THE COURT'S HOLDING IS REQUIRED BY THE PRIOR
DECISION IN CITY OF DETROIT**

Contrary to the Commission's implication at the outset of its Petition for Rehearing, the holding herein is required by the decision in *City of Detroit*. In that case, the Commission itself had held that to deprive Panhandle of any part of the benefits of accelerated amortization would frustrate the Congressional purpose of offering an incentive to stimulate additional capital investment (*Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53, 82-84 (1954)). And on review, instituted by municipal intervenors on this issue, as well as others, the Court expressly affirmed the Commission's position that the taxpayer, rather than the consumer, was the beneficiary intended by Congress (97 App. D.C. at 272, 230 F. 2d at 822):

"Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. *The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings.* In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated."²

In so holding, this Court was fully aware of the nature of the benefits it decided belonged to Panhandle (*Ibid.*):

"The funds go into a reserve account for the payment of the deferred taxes to accrue after the five year

¹ The power to grant rehearing *en banc*, it has been observed, should be exercised with "moderation and self-restraint." Cf. *Cafeteria & Restaurant Workers Union, Local 473 v. McElroy*, 284 F. 2d 173, 186 (1960) (Danaher, J. concurring), *aff'd*, 367 U.S. 886 (1961).

² Emphasis is supplied throughout this Answer unless otherwise indicated.

amortization period. *Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from Section 124A [present section 168]. [Footnote omitted] This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress."*

Thus, as the Court properly concluded in its present decision, "In the *City of Detroit* case the question whether temporary income tax savings resulting from accelerated amortization should be divided between the company and the ratepayers was presented, and was answered in the negative by the Commission and by this court * * * (Slip Op., p. 8). Indeed, as the Court also pointed out in its opinion herein (Slip Op., p. 8), the Commission in its Opinion No. 342, *Northern Natural Gas Co.*, 25 F.P.C. 431 (1961), (on which the Commission order herein was based) recognized that the thrust of the Court's decision in *City of Detroit* was to require the allowance of a full return to Panhandle on the funds involved (25 F.P.C. at 437). However, the Commission declined to follow it because "more careful consideration (had) * * * disclosed [it] to be erroneous" (*Ibid.*). Thus, it is apparent that the only problem presented by the instant case arises from the Commission's deliberate refusal to follow this Court's *City of Detroit* holding—a holding which sustained the Commission's former position (Cf. Slip Opinion, p. 8).³

To be sure, Judge Bazelon disagreed with the majority's holding as to the controlling effect here of *City of Detroit*. In his view, in that case "The question of what return should be allowed on reserves set up to 'normalize' tax payments was not presented for decision" (Slip Opinion, p. 12). But what Judge Bazelon overlooked was that the

³ This conclusion is reinforced by the Commission's reference (Petition, p. 6) to its pending proceeding in *Alabama-Tennessee Natural Gas Company*, Docket Nos. G-5471, et al.

Commission's present formulation of the issue is nothing more than an attempt to do in another way here what it was forbidden to do in *City of Detroit*. In other words, it is a device designed to circumvent this Court's holding in *City of Detroit*.

Limiting Panhandle to a 1.5 percent return on facilities financed by tax accruals in order "to divide the benefits of liberalized depreciation between the regulated company and the ratepayer," with "the major portion of the benefits" going to the customers (Slip Opinion, pp. 7-8), in effect accomplishes the same end result as deducting 77 percent of Panhandle's deferred tax accruals from the rate base.⁴ In these circumstances, it is immaterial whether the issue is phrased in terms of "fair rate of return" or "rate base". In both cases the same end-result is achieved (Joint Appendix, pp. 1351-2, 1756, 2485).⁵ The plain fact is that in order for Panhandle to benefit equally with other taxpayers from Sections 167 and 168, it must be allowed not only to include the funds temporarily generated under those sections as a part of its rate base, but also to earn a full return thereon. To allow Panhandle to include the funds in its rate base but to deny it a full return on them is merely to take back with the left hand something which has been given by the right.

II

THERE IS NO OCCASION FOR THE COURT TO RECONSIDER CITY OF DETROIT

As stated above, what the Commission really seeks is reconsideration of the basic rule of *City of Detroit*. But this Court's reading of the legislative history and purpose was adopted initially in a unanimous opinion by Judges

⁴ See p. 16 of Panhandle's Initial Brief herein. The "flow through" method referred to in the Commission's Petition would, of course, be tantamount to deducting the entire amount from the rate base.

⁵ The *amicus* brief of the Michigan Public Service Commission frankly admits this fact (Br., p. 8).

Fahy, Danaher and Bastian. Writing for the majority in the present case, Chief Judge Miller indicated that even if the matter were considered as a question of first impression, the same result would be reached. And Judge Burger added in his concurrence that *City of Detroit* is controlling until judicially established to be erroneous (Order of October 15, 1962). Thus, this issue has already been passed upon by six judges now sitting on this Court, five of whom have manifested agreement that the Congressional intent can be effectuated only by permitting the taxpayer to retain the full benefits of Sections 167 and 168. Moreover, as is shown hereinafter, the various reasons advanced by the Commission for the overruling of *City of Detroit* are without merit.

A. The Court's Decision Is Not Novel and Will Not Have Any Disruptive Effect

The Commission argues that the Court's decision "will have a disruptive effect far beyond this case and the operations of the Federal Power Commission" (Petition, p. 2). But in so urging, the Commission overlooks the fact that since the decision in *City of Detroit* and until its recent opinion in *Northern Natural Gas Co.*, 25 F.P.C. 431 (1961), the Commission itself has consistently allowed pipeline companies to retain the full benefits of Sections 167 and 168. There is no indication—and the Commission asserts none—that during this period there was any disruptive effect upon the operations of the Commission as a result of this effectuation of the clear Congressional intent.

This prior consistent Commission practice belies the Commission's further assertions that the decision lays down a novel rule which has not been reached by any "regulatory agency or court, other than the panel of this Court deciding the present case, * * *" (Petition, p. 4). In this regard, the holding of the Court of Appeals for the Fifth Circuit in *El Paso Natural Gas Co. v. F.P.C.*, 281 F. 2d 567 (1960), *cert. denied*, 366 U.S. 912 (1961),

should also be noted. While the Fifth Circuit Court ruled that the tax benefits of percentage depletion and intangible well drilling costs, as such, are to be passed on to the consumers (281 F. 2d at 571-73), that Court went on to hold—a holding which the Commission seeks to minimize (Petition, p. 5, fn. 5)—that the taxpayer was entitled to retain the benefits flowing from the use of liberalized depreciation (281 F. 2d at 573-74):

“The one exception, if it be an exception, is the treatment to be afforded the tax saving or deferral resulting from the use by the taxpayer of the declining balance method of depreciation of new equipment. In practical effect this works a tax deferral rather than a tax savings. If the company were charged for rate making purposes with such ‘savings’ during the year in which the depreciable assets were acquired, and the rate resulting from such treatment of the taxes was thereafter used for later years, as is here the case, it is clear that the company would be paying higher taxes in subsequent years than in the test year, but would not be entitled to an adjustment in rates to cover the increase. Therefore, we approve the Commission’s treatment of the ‘saving’ resulting from using the declining balance method of depreciation for tax purposes but computing its taxes for rate making purposes on the straight line method of depreciation, placing such ‘savings’ in a special reserve to be used to equalize tax payments in later years. These amounts can never represent added return to the company because of the restriction as to their use.”⁶

⁶ *Lexington, et al v. F.P.C.*, 295 F. 2d 109 (4 Cir., 1961), presents no conflict with the Court’s holding here. In that case, the Commission had included the properties financed by tax accruals resulting from the use of liberalized depreciation in the company’s rate base at full return and the Court of Appeals affirmed, thereby arriving at the same result as has this Court in the instant case. True, the Court’s reasoning was more limited than that of this Court, but the posture of the case as presented to the Fourth Circuit did not call for any broader ruling. In this regard, it should be noted that the Fourth Circuit agreed with the holding here as well as that of the Fifth Circuit in *El Paso*, that the use of liberalized depreciation results in a tax deferral, not a tax saving. See 295 F. 2d at 111-112.

Contrary to the Commission’s contention (Petition, p. 2), the present decision is not inconsistent with *Panhandle Eastern Pipe Line Co.*, ... App.

The fact that the present decision merely reaffirms the rule of *City of Detroit* serves also to undercut the Commission's prophesy that the former will have "adverse effects upon well-considered policies and practices of a great many state and federal administrative agencies * * *" (Petition, p. 6). To be sure, the Commission cites a number of administrative decisions which it says expressly or impliedly disagreed with and rejected the "Court's reading of legislative history and intent in its *City of Detroit* opinion" (Petition, p. 3).⁷ Suffice it to note here that most of these decisions were rendered after *City of Detroit* was issued in 1955. If these administrative bodies read the Congressional intent as allowing consumers to share the tax benefits, they did so despite the existence of this Court's unanimous 1955 decision to the contrary. Obviously, the present decision, which reaffirms the rule of *City of Detroit*, will create no additional legal problem.⁸

D.C., 305 F. 2d 763, 767 (1962). There the Court was not concerned with *tax deferrals* under Sections 167 and 168, but only with the *tax savings* resulting from the deductions from percentage depletion and intangible well-drilling and development costs allowed to producers of natural gas by Internal Revenue Code Sections 611-613 and 263(c), 26 U.S.C. §§ 611-613 and 263(c). We explained the significance of this distinction in our Reply Brief, pp. 18-19.

⁷ The Commission's implication that "virtually every regulatory commission in the 50 states" has ruled contrary to this Court's decision (Petition, p. 6) is belied by the compilations which it cites (*Id.* at page 3 and note 3). As there set out, there is a division among the State Commissions regarding the treatment of accelerated amortization and liberalized depreciation. But those Commissions which have "rejected * * * *City of Detroit* * * *" have plainly ignored the Congressional intent. Indeed, in explaining the inapplicability of these state decisions in its brief in opposition to certiorari in *California v. F.P.C.*, Oct. Term, 1960, No. 599, page 15, the F.P.C. commented that: "The state commission cases have seldom, if ever, involved the natural gas pipeline industry. Continued expansion for the indefinite future can more readily be assumed for the electric power and telephone industries than for gas pipelines, which are dependent on the continuing discovery of exhaustible reserves * * *."

⁸ The Commission states that "the present decision is probably not legally binding on state regulatory agencies * * *" (Petition, p. 5).

B. The Congressional Intent to Benefit the Taxpayer, Not Consumers, Is Controlling

The Commission urges that the effect to be given Sections 167 and 168 "must be evaluated in light of expert judgments as to probable industry developments rather than by *a priori* reasoning" (Petition, p. 7; see also pp. 11, 12). This argument is wholly without merit. The question as to the effect to be given Sections 167 and 168 is entirely one of Congressional intent in enacting these provisions. Not only are "expert judgments as to probable industry developments" irrelevant, but the Commission does not, contrary to its implication, have any special expertise to decide the legal question presented. Cf. *Texas Gas Transmission Co. v. Shell Oil Co.*, 363 U.S. 263 (1960).

Despite its current protestations, the Commission has in the past recognized the controlling nature of the Congressional intent, and on the basis of this legislative purpose, has reiterated that Sections 167 and 168 were not designed to benefit the consumers in any part. Speaking of Section 167, the Commission has acknowledged that "the intent of Congress was *not* to benefit consumers" *El Paso Natural Gas Co.*, 22 F.P.C. 260, 266 (1959).⁹ And regarding Section 168 the Commission ruled recently that "the accelerated amortization provisions were to benefit the taxpayer, *not* the consumers." *Phillips Petroleum Co.*, 24 F.P.C. 537, 570 (1960).¹⁰

This is the view of Congressional intent which this Court adopted in *City of Detroit*, wherein the Court held (97 App. D.C. 260, 272, 230 F. 2d 810, 822):

" . . . [T]he intent of Congress reflected in Section 124A [now 168] is *not* to benefit consumers

⁹ Remanded on other grounds sub nom. *El Paso Natural Gas Co. v. F.P.C.*, 281 F. 2d 567 (5 Cir. 1960), cert. denied sub nom. *California v. F.P.C.*, 366 U.S. 912 (1961).

¹⁰ Affirmed . . . App. D.C. . . ., 303 F. 2d 380 (1961), cert. granted, 369 U.S. 870 (1962).

but rather the taxpayer in order to encourage construction of certain emergency types of facilities * * *. This statute, unlike the Natural Gas Act itself, is *not* for consumer benefit."

The Court also observed that (*Id.* at n. 17):

"* * * [T]here is *no* indication of a Congressional intent to benefit consumers."

Similarly, the taxpayer was allowed to retain the full benefits of Section 167 in the Fifth Circuit Court's decision in *El Paso Natural Gas Co. v. F.P.C.*, *supra*.

The legislative history interpreted by the Commission and this Court is fully discussed in our briefs. Like the decisions quoted above, these legislative materials amply support the Court's conclusion in the present decision that "Congress has not provided that, with respect to utilities, ratepayers are entitled to share in the temporary benefits resulting from the use of liberalized depreciation in computing income taxes" (Slip Op., p. 9).

The Commission further contends (Petition, p. 12) that its proposal would achieve the same result as that produced for unregulated industries by "the forces of competition." These competitive forces are said to "determine whether a tax benefit will ultimately redound to the stockholder by way of larger profits or to the customer through lower prices * * *." But the Commission's assumption in this regard is without any support in the record or in the legislative history. Indeed, the Commission did not predicate its decision on the grounds which it now undertakes to supply. Obviously, the legal infirmity in the Commission's order cannot be cured by this belated attempt to supply different grounds than those relied on by the Commission in its order. *S.E.C. v. Chenery Corp.*, 318 U.S. 80, 87 (1943); *Boudin v. Dulles*, 98 App. D.C. 305, 235 F. 2d 532 (1956); *N.L.R.B. v. Capital Transit Co.*, 95 App. D.C. 310, 221 F. 2d 864 (1955). In any event, the Commission's

present argument with regard to unregulated industries is contrary to the Congressional intent. In enacting Sections 167 and 168, Congress was concerned with increasing investment in new productive facilities rather than with price reductions. See *El Paso Natural Gas Co.*, *supra*, 22 F.P.C. at 266; *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 F.P.C. 369, 370 (1953); *Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53, 82 (1954).

Congress' understanding that the taxpayer would in fact retain all the tax benefits may be further illustrated by the investment credit provision of the new Internal Revenue Code of 1962. In its Petition, the Commission refers to this provision and cites selected excerpts from the hearings and debates (Petition, p. 12, note 12 and Appendix D); but it omits any reference to the statement in the Senate Report that the credit was designed to "have the effect of increasing the earnings of new facilities . . . and . . . the profitability of productive investment" (S. Rep. No. 1881, 87th Cong., 2d Sess., p. 11). No mention was made of lower prices to consumers. Significantly, the Conference Report similarly described the purpose of the credit as being

"in the case of both regulated and non-regulated industries, . . . to encourage modernization and expansion of the Nation's productive facilities and to improve its economic potential by reducing the net cost of acquiring new equipment, thereby increasing the earnings of the new facilities over their productive lives." (H. Rep. No. 2508, 87th Cong., 2d Sess., p. 14).

The Commission also implies that the Court's ruling will mean that "utility stockholders must be afforded an additional return over and beyond what would otherwise be just and reasonable" (Petition, p. 11). But to allow Panhandle to earn a full return on its facilities financed by tax accruals will not result in an unreasonable return. Under traditional regulatory standards, there is no reason why

customers should not pay the company a fair return upon the entire corporate investment in the facilities which it owns and which are devoted to customer service. "This does not allow Panhandle for rate purposes more than a fair return over the long period, but does recognize the grant by Congress of certain temporary tax savings * * *." See *City of Detroit v. F.P.C.*, 97 App. D.C. at 271, 230 F. 2d at 821, quoting 13 F.P.C. 53, 83.

C. The Court Properly Held That Sections 167 and 168 Result in a Tax Deferral, Not a Tax Saving

The Commission alleges that the Court erred in recognizing (Slip Op., p. 2) "that accelerated amortization or liberalized depreciation produces only temporary tax savings * * *" (See Petition, pp. 7-11). The Commission concedes (Petition, pp. 7-8) that accelerated amortization under Section 168 results in a tax deferral. But it contends that liberalized depreciation under Section 167 should be viewed differently. This is indeed a strange argument to be made by the Commission, which has consistently recognized in the past that the two statutory provisions produce the same results and should be treated alike. Indeed, in this very case, the Commission treated these two provisions alike, denying to Panhandle the major part of the benefits of both. And as recently as Opinion No. 342, upon which the instant order is based, the Commission refused to distinguish between the two statutory provisions (25 F.P.C. at 437):

"* * * We believe it wiser not to attempt to distinguish between these two statutes but to adopt the same view as to all tax accruals, whether obtained from use of Section 167, dealing with liberalized depreciation, or Section 168, dealing with accelerated amortization."

The Commission's present position, that liberalized depreciation may produce a tax saving, is also contrary to an unbroken series of Commission decisions holding that,

like Section 168, Section 167 results in a tax deferral, not a tax saving. Thus, in *Amere Gas Utilities Co.*, 15 F.P.C. 781, 782 (1956), the Commission found that Section 167 "operated to create a *deferral* of taxes * * *" (15 F.P.C. at 782). More recently, in *El Paso Natural Gas Co.*, *supra*, the Commission held that under Section 167 "There is thus a *deferral* of taxes * * *" (22 F.P.C. at 267). And in *United Fuel Gas Co.*, 23 F.P.C. 127, 130 (1960),¹¹ the Commission noted that Congress intended the taxpayers to retain "the tax *deferrals* arising from liberalized depreciation * * *."

Other Federal Courts which have passed upon the question have similarly held that Section 167 results in a tax deferral. In *El Paso Natural Gas Co. v. F.P.C.*, *supra*, the Fifth Circuit concluded that Section 167 "works a tax *deferral* rather than a tax savings" (281 F. 2d at 573). Cf. *City of Detroit*, 97 App. D.C. at 271, 230 F. 2d at 821. These decisions clearly conform to Congress' understanding that Section 167 "merely affect[s] the timing and not the ultimate amount of depreciation deductions with respect to a property." See H. Rep. No. 1337, 83rd Cong., 2d Sess., p. 3 (1954).

Nor is there any merit to the Commission's contention that its *Amere* decision "was based on a purely arithmetical analysis of the effect of liberalized depreciation as applied to the acquisition of a specific asset" (Petition, p. 8). Actually, in *Amere* the Commission considered the very hypothesis of continuing plant additions which it now asserts in its Petition would result in a permanent tax saving. It there concluded that even with continuing plant additions, "there is a continuing tax *deferral* so long as additional facilities are being installed" (15 F.P.C. at 782).¹²

¹¹ *Aff'd in part sub nom. Cities of Lexington, etc., Ky. v. F.P.C.*, 295 F. 2d 109 (4 Cir., 1961).

¹² *Accord General Passenger Fare Investigation*, CAB Order E-16068, *mimeo.*, p. 67 and App. A, pp. 91-92 (November 25, 1960).

Similarly, there is no merit to the contention that in *Amere* the Commission took a "cautious, wait-and-see approach * * *" (Petition, p. 10). Actually, *Amere* was a rule making proceeding which included Panhandle's request for a declaratory order upon which it relied before exercising its election under Section 167. Moreover, such contention ignores the Commission's own definitive actions. Thus, because it questioned whether the natural gas industry needed the incentive of Section 167, the Commission transmitted a copy of its *Amere* opinion to Congress (15 F.P.C. at 782), which has not changed the law in this respect. As shown above and in our briefs, it continued to follow *Amere* in its decisions. Indeed, the Commission acknowledges that even as late as the order under review, it "did not attempt a reexamination of the conclusion originally reached in the *Amere* case * * *" (Petition, p. 11).¹³

In now arguing that liberalized depreciation will result in a tax saving, the Commission acknowledges that liberalized depreciation results in a tax deferral if "viewed in relation to * * * a particular depreciable asset (or to * * * those assets acquired by the taxpayer in a particular year)" (Petition, p. 9). But, it claims that liberalized depreciation "would provide permanent savings" when applied to a plant with constant asset replacement or expansion (Petition, p. 10). This very approach now espoused by the Commission had been consistently rejected by the Commission itself until the filing of this Petition for Rehearing.

¹³ Unless the company is allowed to treat liberalized depreciation as a tax deferral and accrue funds, it would receive no benefits from its use of Section 167. It is noteworthy that in Opinion No. 342, the Commission found that it would be contrary to the public interest to adopt a policy "which would give all of this advantage to the ratepayer and none to the company, and which, as experience has shown, will very probably result in the failure of the company to use liberalized depreciation * * *" (Resp. Br., p. 49).

In its brief in opposition to the grant of certiorari in the *El Paso* case, the Commission advised the Supreme Court that:

"In any event, the result of an increasing plant account would not affect the legal validity of the Commission's decision. The tax benefit resulting from the liberalized depreciation granted in connection with a particular unit of property ends with the life of that unit. The fact that other benefits will be beginning with respect to other units does not change the effect of the way in which the earlier unit was depreciated. The portion of the reserve set up in connection with that unit will have grown, declined, and disappeared, and will have performed its function of causing the corresponding depreciation charges to be properly reflected, year by year, in the amount of taxes included in cost of service for rate-making purposes."¹⁴

Furthermore, even if the total business or plant approach were proper, it would not follow, at least for Panhandle, that liberalized depreciation would result in a tax saving. The Commission assumes that "a company maintains a steady pattern of capital asset acquisitions at least equal to retirements . . ." (Petition, p. 9). But it ignores the fact that Panhandle's primary function is to deliver gas from gas reserves which have a limited life. The Commission itself has recognized the limited life of Panhandle and other pipeline companies by fixing the service lives of their transmission properties, for depreciation purposes, far shorter than the actual physical lives thereof. See *Panhandle Eastern Pipe Line Company*, 13 F.P.C. 53, 88-89, 93 (1953); *Canadian River Gas Company*, 3 F.P.C. 32, 52-57 (1942), affirmed, 324 U.S. 581 (1945); *Interstate Natural Gas Company*, 3 F.P.C. 416, 423-4, affirmed, 331

¹⁴ Brief of the Federal Power Commission in Opposition to Petition for Writ of Certiorari, *California v. Federal Power Commission*, October Term 1960, No. 599, p. 16.

U.S. 682 (1947). As the Supreme Court recognized in *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 606 (1944):

“The ultimate exhaustion of the supply is inevitable in the case of all natural gas companies.”

Panhandle's ability to expand and to acquire new property is also subject to other risks, including competition from other fuels and from other sources of energy, general economic declines and capital scarcity.

Finally, the Commission's present position is unsupportable because it assumes that statutory authorization of liberalized depreciation will continue indefinitely. But bills to repeal these tax provisions have been introduced frequently (See, e.g., H.R. 127, H.R. 4806, H.R. 9544, H.R. 8120, 85th Cong., 1st Sess. (1957)). With such repeal, taxes would immediately increase even if the plant were to continue to expand, since the continuing effect of liberalized depreciation on older assets would not be offset by any reduction in taxes by virtue of liberalized depreciation on newer assets. The result in such case would be to impose an even greater disproportionate burden on the then consumers. Apparently, in recognition of the above considerations, the Commission in its brief to the Supreme Court in opposition to certiorari in the *El Paso* case, stated (pp. 14-15) that “* * * assumptions of a continual plant growth and a continuously expanding investment in depreciable property, i.e., plant additions exceeding retirements, are at best largely speculative and conjectural.
• • •”

D. The Present Decision Does Not Operate to Increase the Rates Paid by the Consumers

Asserting that under the present decision, the return and associated taxes on industry-wide deferred tax accruals attributable to liberalized depreciation “would cost the consumers about \$32½ million in 1962, in contrast with the cost of about \$7.8 million under the Commission's

decision * * * (Petition, p. 14),¹⁵ the Commission implies that the present decision will result in increased rates to the consumers. This implication is wholly unwarranted. As this Court stated in *City of Detroit*, 97 App. D.C. at 272, 230 F. 2d at 822:

"* * * The solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress."

What the Commission now ignores is the controlling fact that if Panhandle were allowed a rate of return of 6.46 percent on the facilities financed by its deferred tax accruals, its customers would pay virtually the same rate upon the facilities financed by such accruals as they would pay if, instead of electing to use Section 167, Panhandle had obtained its financing from its conventional sources of capital. As the Commission correctly concluded in *United Fuel Gas Co.*, 23 F.P.C. 512, 513 (1960), *aff'd in part sub nom. Cities of Lexington, etc., Ky. v. F.P.C.*, 295 F. 2d 109 (4 Cir., 1961): "The customer is not injured by liberalized depreciation; it pays a rate as though this tax incentive did not exist."

The Commission now implies that ratepayers should be spared these normal capital and tax costs because the tax accruals were "paid to the companies by their ratepayers * * *" (Petition, p. 14). But the Commission is clearly in error in regarding tax accruals from use of liberalized depreciation as contributions by customers. For as the Commission itself acknowledged in *United Fuel Gas Co.*, *supra*, 23 F.P.C. at 513, such funds are tantamount

¹⁵ The Commission also contends that "The Court's present decision would cost the consumers about \$160 million more in 1962 than they would pay under flow-through * * *" (Petition, p. 14, n. 18). We note that the Commission gives no support for any of its figures, which are admittedly "very rough" (*Id.* at n. 17).

to "a loan not from the customers but *from the government.*"

In this connection, the Commission further asserts that, "As Judge Bazelon stated (Slip Op., p. 10), there is no suggestion that the 6.25% return allowed is insufficient to meet the standards of the Natural Gas Act" (Petition, pp. 14-15). We disagree.¹⁶ The Commission found here that a fair over-all rate of return for Panhandle would be 6.46 percent if based on the average cost of Panhandle's *actual* capitalization. To be sure, the Commission reduced this over-all rate by allowing a return of only 6.25 percent. But the Commission's reduction was based solely upon its decision to deprive Panhandle of the major portion of its tax benefits. Since the Commission's treatment of Panhandle's tax benefits has now been judicially found to be illegal, the Commission's reduction of Panhandle's over-all return is likewise illegal (See our Reply Brief, pp. 11-13).

¹⁶ Panhandle clearly contended in both its Petition for Review (p. 9) and in its initial brief (p. 29) that the Commission's over-all rate of return allowance of 6.25 percent is unjust and unreasonable.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the Commission's Petition for Rehearing *En Banc* should be denied.

Respectfully submitted,

PANHANDLE EASTERN PIPE LINE COMPANY

By /s/ HARRY S. LITTMAN
Its Attorney

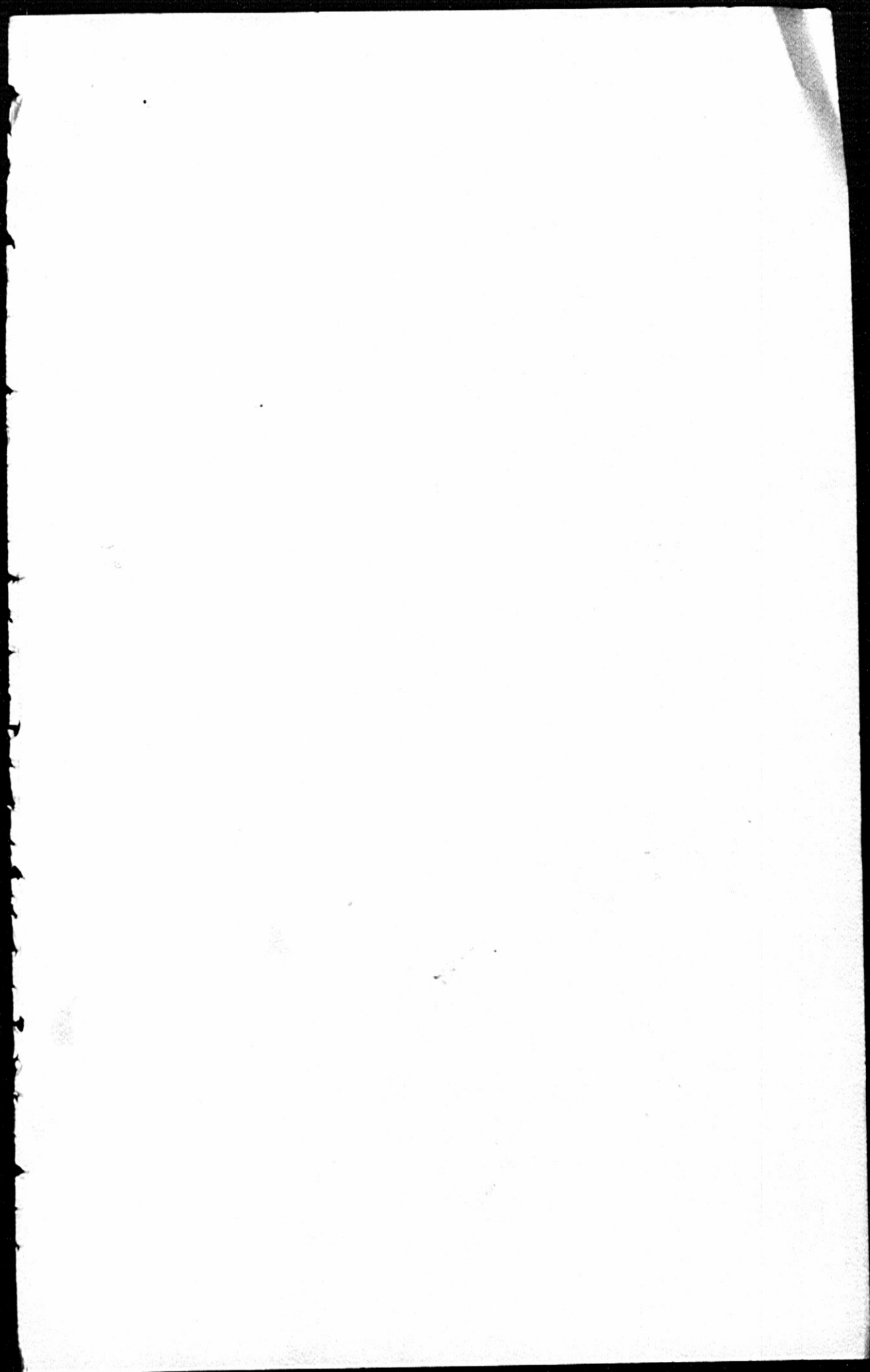
HARRY S. LITTMAN
DALE A. WRIGHT
RICHARD LITTELL
MELVIN RICHTER
317 Wyatt Building
Washington 5, D. C.

JOSEPH J. DANIELS
BAKER & DANIELS
810 Fletcher Trust Building
Indianapolis 4, Indiana

ROBERT P. PATTERSON, JR.
PATTERSON, BELKNAP & WEBB
1 Wall Street
New York 5, New York

*Attorneys for
Panhandle Eastern Pipe Line Company*

October 22, 1962



BRIEF AMICUS CURIAE OF INDEPENDENT NATURAL
GAS ASSOCIATION OF AMERICA IN SUPPORT OF PAN-
HANDLE EASTERN PIPE LINE COMPANY'S PETITION
FOR REHEARING EN BANC

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

On Petition to Review an Order of the Federal
Power Commission

On Rehearing en Banc

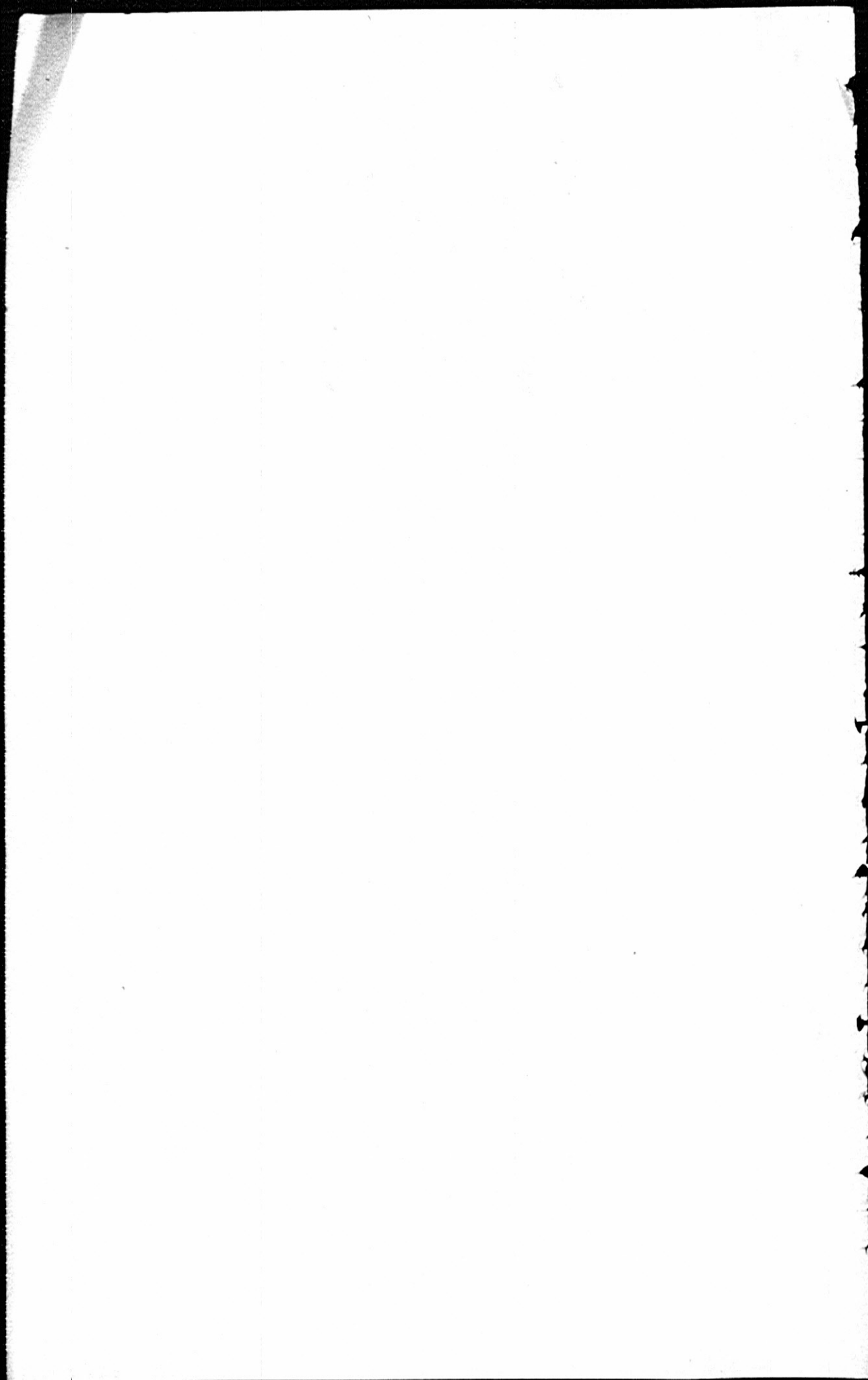
United States Court of Appeals
for the District of Columbia Circuit

FILED APR 18 1963

JOHN T. MILLER, JR.
1001 Connecticut Avenue, N.W.
Washington 6, D. C.

Nathan J. Paulson Clerk Independent Natural Gas Association
of America

April 2, 1963



IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*,

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**BRIEF AMICUS CURIAE OF INDEPENDENT NATURAL
GAS ASSOCIATION OF AMERICA IN SUPPORT OF PAN-
HANDLE EASTERN PIPE LINE COMPANY'S PETITION
FOR REHEARING EN BANC**

The March 15, 1963 *en banc* decision filed by a bare majority of this Court is, we respectfully submit, erroneous and should be vacated. The September 27, 1962 decision filed herein by a division of the Court should be reinstated.

1. The March 15 Decision Does Not Serve the Purposes for Which En Banc Hearings Are Intended

Section 46(c) of Title 28 of the United States Code provides:

"Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court in banc shall consist of *all active circuit judges* of the circuit." (Emphasis supplied)

This provision found its genesis in a proposal made to Congress in 1944 by Circuit Judge Maris. "It was motivated by a dual purpose: to give express recognition to the doctrine of *Textile Mills* [314 U.S. 326 (1943), which sustained the power of a Court of Appeals to order a hearing *en banc*], while at the same time securing the tradition of three-judge courts against any further intrusion."¹

The Supreme Court has recently stated in *United States v. American-Foreign Steamship Corp.*²:

"*En banc* courts are the exception, not the rule. They are convened only when extraordinary circumstances exist that call for authoritative consideration and decision by those charged with the administration and development of the law of the circuit."

The Supreme Court made it clear that an essential element to an *en banc* proceeding is that it will serve to secure

¹ *Western Pacific Railroad Corp. v. Western Pacific Railroad Co.*, 345 U.S. 247, 254 (1953). Fears had been expressed by the then Senator Danaher as early as 1941 that *en banc* proceeding might be used at the expense of the three judge divisions. See Hearings before a Subcommittee of the Senate Committee on the Judiciary, 77th Cong., 1st Sess., on S. 1050 *et al.*, pp. 18-19 (1941).

² 363 U.S. 685, 689 (1960).

uniformity and continuity in the Court's decisions for the foreseeable future:

"The principal utility of determinations by the courts of appeals in banc is to enable the court to maintain its integrity as an institution by making it possible for a majority of its judges always to control *and thereby to secure uniformity and continuity in its decisions*, while enabling the court at the same time to follow the efficient and time-saving procedure of having panels of three judges hear and decide the vast majority of cases as to which no division exists within the court. . . ." (Emphasis supplied.)³

So strongly does the Supreme Court believe that this is the result intended by Congress, that it ruled, in the foregoing case, that a retired judge may not participate in an *en banc* decision even though he was a member of the panel which originally heard the case and had not yet retired at the time of the *en banc* hearing.⁴ "Indeed, Congress may well have thought that it would frustrate a basic purpose of the legislation not to confine the power of *en banc* decision to the permanent active membership of a Court of Appeals."⁵ In an appropriate case,

"*en banc* determinations make 'for more effective judicial administration. Conflicts within the circuit will be avoided. Finality of decision in the circuit courts of appeal will be promoted. Those considerations are especially important in view of the fact that in our federal judicial system these courts are the courts of last resort in the run of ordinary cases.' *Textile Mills Corp. v. Commissioner*, 314 U.S., at 334-345."⁶

³ 363 U.S. at 689, quoting *Maris, Hearing and Reharing Cases in Banc*, 14 F.R.D. 91, 96 (1954).

⁴ *United States v. American-Foreign Steamship Corp.*, *supra*.

⁵ *Id.* at 689.

⁶ *Ibid.*

Turning now to the case at hand, the March 15 *en banc* decision filed herein reflected a 5-4 difference of opinion among the judges participating. The deciding vote was cast by Judge Edgerton, whose successor was confirmed by Congress on the very same day. We submit that the purposes of an *en banc* determination could not properly be served under such circumstances, particularly where the views of the minority are expressed with such vigor.

There can be no question that the issues before the Court in this case are important. The natural gas pipeline industry regulated by the Federal Power Commission has built up substantial deferred tax accruals through use of liberalized depreciation under Section 167 of the Internal Revenue Code. Most of these reserves were accrued, and invested, in light of the Commission's policies which it had laid down prior to 1961 and which had been affirmed by this Court in *City of Detroit*.⁷ In addition, there is a large number of cases pending before the Federal Power Commission which involve substantially the same issue on the merits as that presented here.

With the retirement of Judge Edgerton a new array of judges in the Court will be established. A new majority could well hold the view expressed by the dissenters from the March 15 decision. In these circumstances "finality of decision in the circuit courts" is not achieved by the March 15 decision. It is, therefore, clear that the view of a majority of "the permanent active membership" of this Court has not been expressed. *American-Foreign, supra*, at page 689.

⁷ *City of Detroit v. Federal Power Commission*, 97 App. D.C. 260, 230 F. 2d 810 (1955), cert. denied, 352 U.S. 829 (1956).

2. The Court Erred in Failing to Give Effect to the Intent of Congress

In its petition for rehearing *en banc*, Panhandle has stated several reasons why the March 15 *en banc* decision herein must be vacated. While we support Panhandle in each of its contentions, we shall limit our comments here to only one—Congressional intent.

The legislative history is clear that Congress intended that the benefits of Sections 167 and 168 be available to *all* segments of the American economy, without any exceptions. Moreover, since enactment of Sections 167 and 168, Congress has been advised on several occasions of the decisions of the Federal Power Commission and of this Court in *City of Detroit* that the liberalized depreciation provision was intended to benefit natural gas pipelines, not their customers. Nonetheless, Congress has declined to change the statute in this regard.

The matter was first brought to Congress' notice by the Commission itself. In 1956, when it decided the *Amere* case, the Commission noted in its Opinion that it was "calling this situation to the attention of the Congress by transmitting copies of the presiding examiner's decision, our opinion herein, and the dissenting opinion attached hereto, to the chairman of the Finance Committee of the Senate and the chairman of the Ways and Means Committee of the House."⁸

During later Senate hearings in 1957, Chairman Kuykendall and the Commission's General Counsel elaborated upon the Commission's action in *Amere* and this Court's decision in *City of Detroit*.⁹

The Antitrust and Monopoly Subcommittee of the Senate Committee on the Judiciary fully explored the decisions

⁸ *Amere Gas Utilities Co.*, 15 F.P.C. 781, 782 (1956). See also *El Paso Natural Gas Co.*, 23 F.P.C. 260, 266-67 (1959).

⁹ *Rapid Amortization in Regulated Industries*, Hearings before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 85th Cong., 1st Sess., pp. 439-440, 923 (1957).

of the Commission and of the Court of Appeals to the effect that Section 167 (as well as Section 168) was not intended for consumer benefit. The findings of the Subcommittee were sent to the chairmen of the Senate Finance Committee and the House Ways and Means Committee.¹⁰

Similarly, in its Annual Reports to Congress for 1956 (pp. 75-76) and for 1957 (p. 75), the Commission specifically discussed both its *Amere* decision and amendment of its Uniform System of Accounts to provide for similar treatment of the benefits of both Sections 167 and 168.

In 1957, opponents of the Commission's past treatment of Sections 167 and 168 unsuccessfully proposed amendments to the Federal Power Act which would have required the Commission to exclude the tax benefits of the two sections for ratemaking purposes.

Thereafter Congress amended both Section 167 and Section 168.¹¹ It has not, however, made any change in the law to indicate that the Commission had misinterpreted the Congressional intent in its earlier opinions, orders and rulings under which the regulated utilities retained the full benefits from accrued deferred taxes.

In view of the above it is difficult to conceive that the Majority could have found that "Nothing in the language or legislative history indicated that Congress considered its [§ 167] regulatory consequences." (slip op., p. 4). This is particularly significant since it is apparent that this is an essential finding of the Majority upon which its entire decision is based.

¹⁰ See S. Rept. No. 1380, 85th Cong., 2d Sess., 81 (1958).

¹¹ Technical Amendments Act of 1938, Title I, § 89(b), 72 Stat. 1665, 1608.

CONCLUSION

It is respectfully submitted, for the reasons set forth above as well as those set out in the petition for rehearing *en banc* filed herein by Panhandle Eastern Pipe Line Company, that the decision of the Court *en banc* filed herein on March 15, 1963 should be vacated and rehearing *en banc* granted. Upon granting of the rehearing, the Court should reverse and set aside the Federal Power Commission's order of March 20, 1961.

Respectfully submitted,

INDEPENDENT NATURAL GAS ASSOCIATION
OF AMERICA

by (s) JOHN T. MILLER, JR.
Its Attorney

Washington, D. C.
April 2, 1963

**AMICUS CURIAE BRIEF FOR
MICHIGAN PUBLIC SERVICE COMMISSION**

**IN THE
UNITED STATES COURT OF APPEALS
FOR DISTRICT OF COLUMBIA CIRCUIT**

No. 16,479

**PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,
vs.
FEDERAL POWER COMMISSION,
Respondent.**

**ON PETITION TO REVIEW AN ORDER
OF THE FEDERAL POWER COMMISSION**

**FRANK J. KELLEY
Attorney General
State of Michigan**

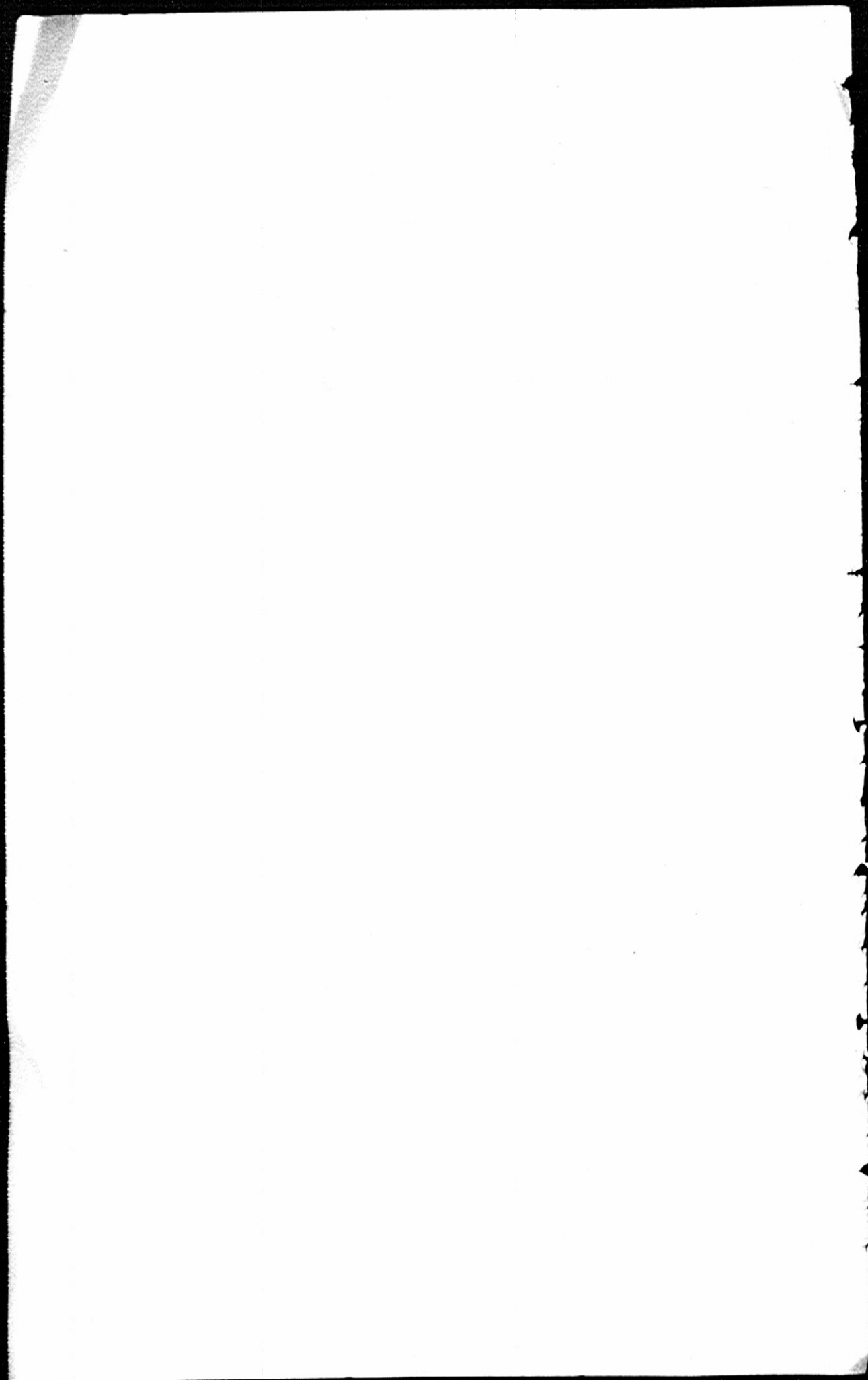
United States Court of Appeals
for the District of Columbia Circuit

**EUGENE KRASICKY
Solicitor General**

**JEROME MASLOWSKI
A. C. STODDARD
BENJAMIN F. GIBSON
Assistant Attorneys General**

**Attorneys for
MICHIGAN PUBLIC SERVICE
COMMISSION**

**Business Address:
504 Lewis Cass Building
Lansing 13, Michigan**



QUESTION PRESENTED

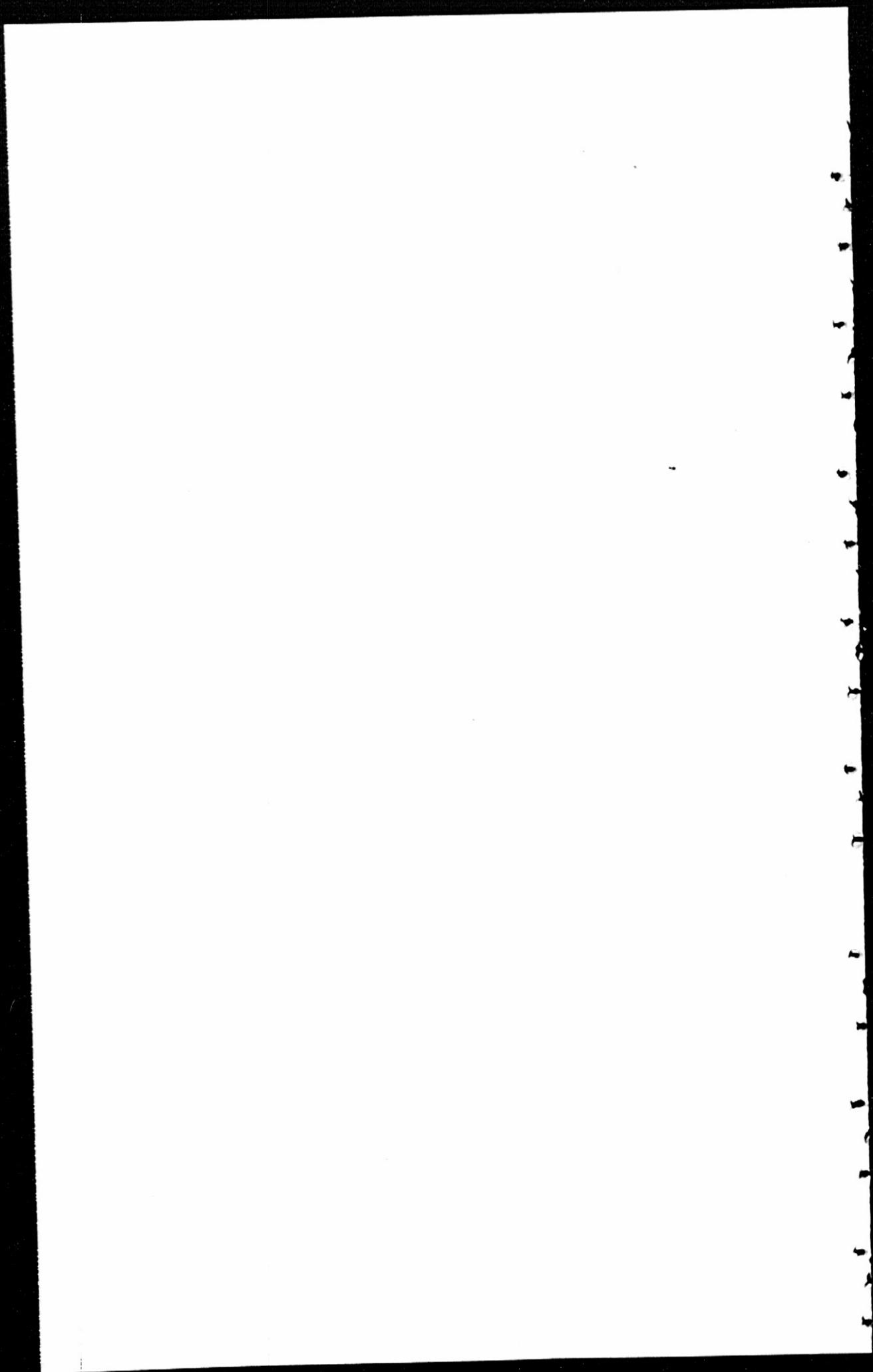
Was it error for the Federal Power Commission to allow a return of 1.5% on an account entitled "Accumulated Deferred Taxes on Income" in which is recorded the difference in the actual income taxes paid by use of liberalized depreciation and accelerated amortization as provided by § § 167 and 168 of the Internal Revenue Code of 1954 and what the taxes would have been by use of conventional straight-line depreciation?

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**ON PETITION TO REVIEW AN ORDER
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Concise Statement Of The Facts

The Federal Power Commission (FPC) issued its Opinion in Docket No. G-19780 on March 20, 1961, which fixed the rate of return for Panhandle Eastern Pipe Line Company (Panhandle) at 6.25%. Included as an element for computing the return was an allowance of 1.5% on a reserve for accumulated deferred taxes on income. This reserve was established to record the difference in the actual taxes paid by Panhandle resulting from the use of depreciation allowance authorized under §§ 167 and 168 of the Internal Revenue Code of 1954 and the taxes Panhandle would have paid if it had used conventional straight-

line depreciation. As of May 31, 1960, Panhandle had accumulated a reserve for deferred taxes which totaled \$11,076,954.

The FPC staff, in seeking to determine the proper treatment to be given to this accumulated reserve in computing rate of return, took the position that no return should be allowed on such accruals. It was argued by the FPC staff that the deferred tax accruals should be considered cost-free capital and included, for purposes of computing the rate of return for Panhandle, at zero interest cost. The accumulated accruals, the staff contended, resulted from funds provided by the customers through the payment of rates and Panhandle did not have to pay for the use of such funds in the form of interest or dividends. Therefore, the staff argued, Panhandle should not be entitled to earn a return on these accumulated reserves.

The position Panhandle took was that it should be allowed to invest the tax savings represented by the deferred tax reserves into plant and that it should be allowed to earn a return on these investments without any adjustment in its rate base.

The FPC, as an incentive to induce a regulated utility to use liberalized depreciation and accelerated amortization as provided by §§ 167 and 168, allowed Panhandle a 1.5% return on the deferred tax accruals. This resulted in an increase in the rate of return from 6.19% to 6.25%.

The Michigan Public Service Commission files this *amicus curiae* brief, urging that the action of the FPC in allowing a return of 1.5% be reversed. The Michigan Commission is vitally interested in, and affected by, the FPC decision because Panhandle sells natural gas to a number of Michigan distribution companies. These companies

distribute gas to the ultimate consumer in many communities in Michigan. The rates paid by ultimate Michigan consumers are affected by the price at which Panhandle sells its gas. The allowance of a return of 1.5% on deferred tax reserves has an effect upon the price of gas sold by Panhandle.

Statement Of Points

It was error for the Federal Power Commission to allow a 1.5% return on deferred income-tax accruals in computing the over-all rate of return of 6.25% granted to Panhandle Eastern Pipe Line Company.

Summary Of Argument

The use of liberalized depreciation methods permitted by §§ 167 and 168 of the Internal Revenue Code of 1954 has reduced the tax payments of Panhandle by \$11,076,954 as of May 31, 1960. This amount was accumulated in deferred income-tax reserve accounts and represents income taxes payable in future periods. The Michigan Commission submits that Panhandle should not earn a rate of return on these accumulated reserves since such amounts result from rates charged to customers. The rates charged to the customers of Panhandle are increased to the extent that Panhandle is allowed to presently provide for taxes which will become due at some future time.

Funds contributed by customers have been consistently held not to be the subject matter of a rate of return. *Milwaukee & Suburban Transport Corp. v. Public Service Comm.*, 13 Wis 2d 384, 108 NW 2d 729; *Hagerstown v. Maryland PSC*, 217 Md 101, 141 A 2d 699, 24 PUR 3d 295;

St. Francis v. Public Service Comm., 270 Wis 91, 70 NW 2d 221; *Fox Point v. Public Service Comm.*, 242 Wis 97, 7 NW 2d 571. A utility should only be permitted to earn on funds contributed by the investor. (Cases cited *supra*.)

The FPC, in adopting a policy of allowing a 1.5% return on deferred income-tax reserves, has taken a position which is inconsistent with its long-standing policy of not allowing a return on funds contributed by customers. See *Transcontinental Gas Pipe Line Corp.*, 14 FPC 94, and cases cited therein.

The Michigan Commission submits that the deferred tax accruals should be included in the computations of the rates of return at zero cost interest. This is the method that was advocated by the FPC staff which would eliminate any windfall to the stockholder to the detriment of the customer.

Panhandle should not have been allowed a 1.5% return on deferred income-tax reserves as an incentive to claim depreciation under §§ 167 and 168. Federal income taxes are expenses like any other expenses of a utility and it is incumbent upon the utility to minimize its expenses of whatever nature. Therefore, Panhandle should not be rewarded for doing that which it has a duty to do.

The policy adopted by the FPC with regards to its treatment of deferred federal income-tax accruals has widespread significance. The allowance of 1.5% return on these accruals will result in a return given to stockholders for which no investment has been made.

Argument

I

Accruals For Deferred Federal Income Taxes Represent Capital Contributed By Customers And Should Not Earn A Return But Should Be Included In The Computation Of The Rate Of Return At Zero Cost Interest

In accordance with accounting rules established by the FPC, Panhandle credits to reserve accounts the difference between federal income taxes actually paid by use of depreciation methods permitted under §§ 167 and 168 of the Internal Revenue Code of 1954 and what the income-tax payments would have been if straight-line depreciation had been used. Debits to this account are made at some future time when the income-tax payments are higher by use of depreciation under §§ 167 and 168 than what such taxes would be by use of straight-line depreciation.

Panhandle has elected to avail itself of §§ 167 and 168 and, as a result, over a period of years, federal income-tax payments were reduced by \$11,076,954 as of May 31, 1960. This amount was accumulated in reserve for deferred income-tax accounts and represents income taxes deferred to some future period. The issue with which we are faced, put succinctly, is whether or not Panhandle should be allowed to earn a rate of return on such accumulated tax deferrals.

The Michigan Commission submits that Panhandle should not be permitted to earn on deferred income-tax accruals. Rather, such accruals should be included in the rate-of-return computation at zero cost interest. The FPC allowed Panhandle a 1.5% return on the accumulated \$11,076,954 as part of the overall return of 6.25%.

The Michigan Commission asserts that Panhandle should not earn a rate of return on its accumulated deferred income-tax accruals because Panhandle has the use of the funds provided by the accruals, interest-free. These accruals are made available to Panhandle for all corporate purposes, except for the payment of dividends, through the rates charged by Panhandle to its customers for natural gas. In short, the rates charged to the customers of Panhandle are increased to the extent that Panhandle is allowed to presently provide for taxes which will, in theory, become due some time in the future. In fact, the FPC recognizes that the customer, in reality, provides the funds for these accruals.

Funds accumulated by contributions by customers have been held, upon many occasions, not to be subject to a rate of return. This principle was reaffirmed in the recent case of *Milwaukee & Suburban Transport Corp. v. Public Service Commission*, 13 Wis 2d 384, 108 NW 2d 729, wherein the Court upheld the Wisconsin Commission's action of deducting the accruals for vacation pay and federal income tax from the rate base. The Wisconsin Supreme Court, in deciding this issue, stated as follows:

"We agree with the commission on this point. The accruals in question represent customer contributions not entitled to earn a return. They are not capital supplied by the stockholders, and to permit them to be included in the rate base would give the stockholders a return on money they did not invest."

It cannot be seriously contended that a utility should be entitled to earn a return on capital not contributed by investors but by the customers. See *Hagerstown v. Maryland PSC*, 217 Md 101; 141 A 2d 699, 24 PUR 3d 295. This same case held that no return was allowable even though

the title to the property furnished by the customers appeared to be in the name of the utility.

The above principles should apply equally to accruals accumulated through the deferral of federal income taxes. These, too, represent funds contributed by the customers and should, in principle, be accorded the same treatment as any other funds contributed or donated by customers. It is difficult to comprehend how the FPC can consistently deduct the average accruals for federal income taxes from the rate base and not similarly treat accruals for deferred federal income taxes. For cases setting forth the position of the FPC, see *Transcontinental Gas Pipe Line Corp.*, 14 FPC 94, and cases cited therein.

A very cogent statement is made by the Illinois Supreme Court in *City of Alton v. Illinois Commerce Commission*, 9 Ill 2d 76; 165 NE 2d 513, 33 PUR 3d 76, wherein the Court makes an excellent case for allowing no return on deferred tax accruals. On pages 86 and 87 of 33 PUR 3d, the Illinois Court significantly makes the following remarks:

“ . . . At this time, we think it permissible for the commission to safeguard the financial integrity of utilities by recognizing as present expenses those tax liabilities which are deferred by use of accelerated depreciation for federal tax purposes.

“The commission may not, however, shift the benefit of accelerated depreciation from the ratepayers to utility shareholders. The commission's order states that prepayment of deferred taxes by present ratepayers will not benefit the company's shareholders because the funds so collected by the company may not be distributed as dividends or transferred to surplus. The order does not provide, however, that the

prepaid funds must be deducted from the company's rate base. If this deduction is not made, the entire benefit of accelerated depreciation goes to the shareholder, since earnings produced by the prepaid funds — either interest if the funds are invested in securities or income if the funds are put into new plant facilities — will belong to the shareholders, who would thus receive a return on money they did not invest in the company.

"The commission's order therefore cannot stand. Funds operated by accruing deferred tax expense, and any facilities financed out of those funds, must be excluded from the rate base . . ." (Emphasis supplied)

It is submitted that the FPC should have treated the deferred tax accruals accumulated by Panhandle in the same manner as the Illinois Supreme Court did in the above-cited case. This same result can be accomplished by treating the tax accruals as capital obtained by Panhandle at zero cost in determining the rate of return. This was the method advocated by the FPC staff. The use of either method gives the same mathematical result.

For other cases holding that a regulated company is not entitled to earn a return on capital which was not contributed by the investors, see *St. Francis v. Public Service Commission*, 270 Wis 91; 70 NW 2d 221; *Fox Point v. Public Service Commission*, 242 Wis 97, 7 NW 2d 571.

From the authorities above cited and from reason and logic, it becomes quite obvious that a utility, and hence its stockholders, should not receive the benefits from capital supplied by the customers. A return should be allowed only on those funds supplied to the utility by investors. The FPC has conceded that in the case of accumulated

accruals for deferred federal income taxes, such accruals result from rates charged to the customer. Since such accruals were not supplied by the investor, no return should be allowed. Therefore, it was error for the FPC to allow Panhandle to earn a return of 1.5% on these deferred tax accruals.

II

It Was Error For The Federal Power Commission To Allow Panhandle To Earn A Return On Accruals For Deferred Income Taxes As An Incentive To Panhandle To Claim Liberalized Depreciation And Amortization Under §§ 167 and 168 Of The Internal Revenue Code Of 1954

The FPC allowed Panhandle to earn a 1.5% return on the accumulated deferred federal income-tax accrual of \$11,076,954 which was the total accrual as of May 31, 1960. The FPC referred to its Opinion No. 342 involving Northern Natural Gas Company in which the FPC stated its reasons for granting a 1.5% return on deferred tax reserves. The principal reason given for this allowance was to the effect that Northern must be given some incentive to claim liberalized depreciation permitted under §§ 167 and 168 of the Internal Revenue Code of 1954. If no return is allowed on these tax accruals, it was urged, there would be no incentive for a utility to use liberalized depreciation methods permitted by the Internal Revenue Code of 1954. Consequently, many utilities would return to straight-line depreciation, so the argument goes, without benefit to anyone. However, it would appear that the use of these funds at zero interest cost accumulated by the use of liberalized depreciation and accelerated amortization would be incentive enough. Besides, anything which leads to the reduction in the cost of gas paid by the ultimate consumer cannot help but be beneficial, in the long run, to the utility.

No attempt shall be made to get into the argument of what the Congressional intent was when §§ 167 and 168 were enacted by Congress. There is all too much literature on the subject supporting both sides of the issue. However, whatever the Congressional intent underlying the passage of §§ 167 and 168, the allowance of a return by the FPC on the basis of incentive is not supportable by the law. In *El Paso Natural Gas Co., v. FPC*, 281 F 2d 567; certiorari denied 366 US 912, the Court of Appeals, referring to percentage depletion allowance, stated at page 571:

“We think that full effect must be given to the Congressional intent to make the several tax savings available to this taxpayer either because it is in the natural gas business or because it is acquiring new equipment subject to the depreciation options of the 1954 act.

“We think, however, that this does not mean that these tax benefits are to be translated into additional profits for the regulated company over and above a reasonable return on its investment. They are available to the regulated companies to make it so much the easier for them, in competition with other fuels and in competition with other industries seeking the investor's dollar to earn a fair return, including the substantial increment of incentive for exploration and development and payment for gas consumed.”

The Court of Appeals in the *El Paso* case (*supra*) went on to say that the Natural Gas Act determines the power of the FPC in regards to natural gas and was controlling over what might or what might not have been the intent of Congress in enacting revenue laws. The following significant statement is made by the Court in the *El Paso* case at page 573:

"We think, in short, that there is no statutory authority for the Commission to treat actual savings in taxes to which natural gas companies are entitled any differently than savings in any other cost of service. It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequence of rate regulation."

Not only should Panhandle not be given an incentive to induce it to claim liberalized depreciation and accelerated amortization under §§ 167 and 168, there would appear to be a duty placed upon Panhandle to take all reasonable steps to minimize its expenses. Surely, it is not unreasonable to expect Panhandle, or any other regulated company, to reduce its tax burden to the absolute minimum. Any other course of action would be incomplete disregard for the interests of the consuming public. Therefore, no incentive need be given Panhandle (if such were legally permissible) to induce it to minimize its tax liability. This course of action should be assumed without incentive or inducement.

III

The Policy Adopted By The Federal Power Commission In Allowing A Return On Accruals For Deferred Federal Income Taxes Has Widespread Significance

With the expansion of the American economy in general and with the rapid expansion of the regulated utility industries in particular, the policy adopted by the FPC with regards to its treatment of deferred federal income-tax

accruals becomes very significant. These accruals in the aggregate will increase over the years. Already total deferred tax accruals for natural-gas pipeline companies alone are in excess of 100 million dollars. This does not include the electric and other utilities subject to FPC regulation. If the deferred tax accruals for all companies under FPC jurisdiction were totaled, the result would be of astronomical proportions. For this reason it becomes imperative that the FPC policy of allowing a 1.5% return on these tax accruals be reversed. It has been demonstrated that such a policy only results in a findfall to the stockholder to the detriment of the rate-paying customer.

Respectfully submitted,

FRANK J. KELLEY

Attorney General
State of Michigan

EUGENE KRASICKY

Solicitor General

JEROME MASLOWSKI

A. C. STODDARD

BENJAMIN F. GIBSON

Assistant Attorneys General

Attorneys for
**MICHIGAN PUBLIC SERVICE
COMMISSION**

Business Address:
504 Lewis Cass Building
Lansing 13, Michigan

**BRIEF AMICUS CURIAE
OF INDEPENDENT NATURAL GAS ASSOCIATION**

IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

On Petition for Review of an Order of the
Federal Power Commission

United States Court of Appeals_____
for the District of Columbia Circuit

FILED JAN 23 1962

Joseph W. Stewart

CLERK

January 23, 1962

LAWRENCE H. GALL,
918 Sixteenth Street, N.W.
Washington, D. C.
*General Counsel for Independent
Natural Gas Association*

QUESTION PRESENTED

The question presented is whether the Natural Gas Act authorizes the Federal Power Commission to give to the rate payer the major portion of the benefits of the liberalized depreciation and accelerated amortization provisions of Sections 167 and 168 of the Internal Revenue Code, where the legislative history, as affirmed by the Commission and this Court, discloses a Congressional intent to benefit only the taxpayer.

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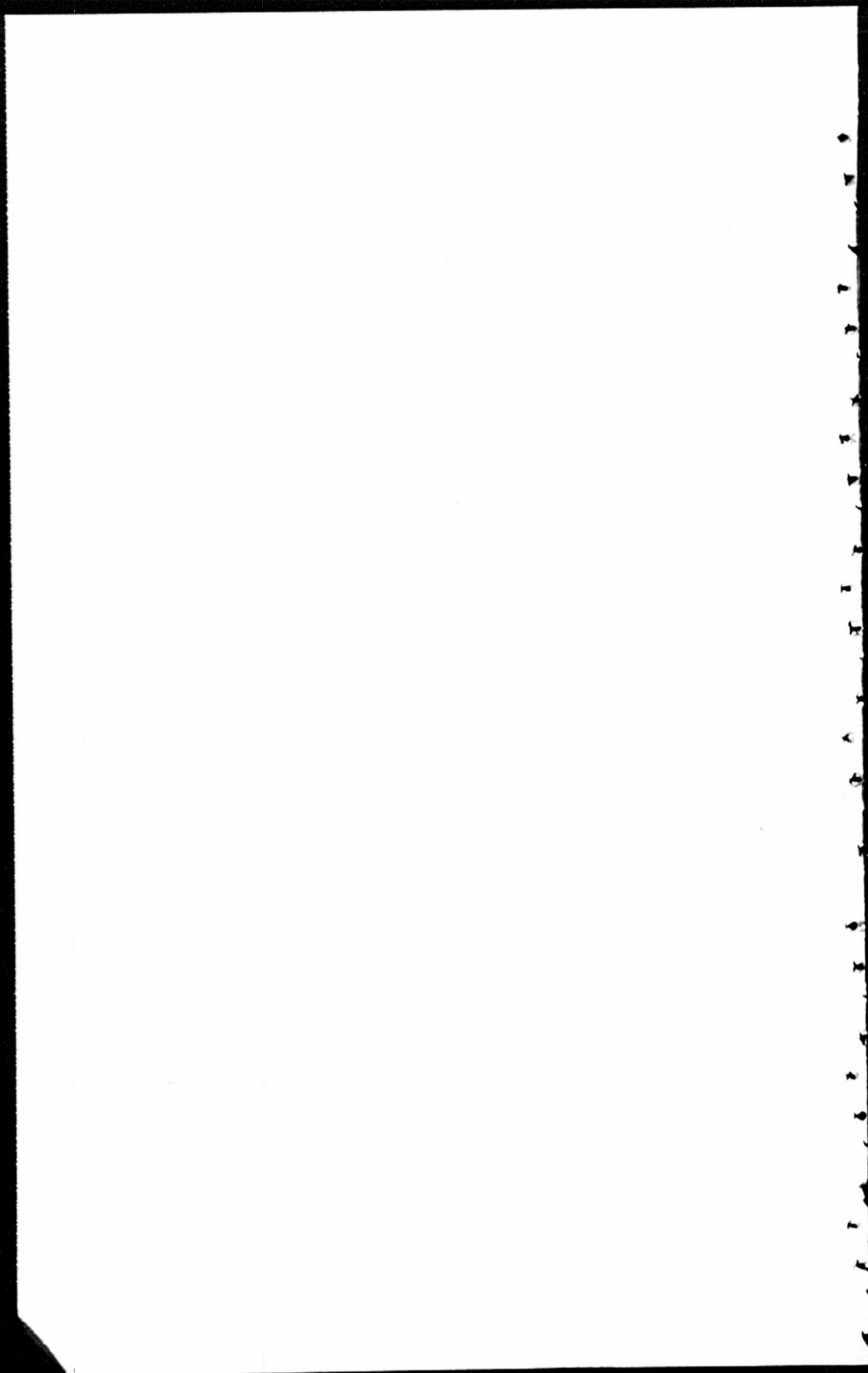
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IN THE
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FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*,
v.
FEDERAL POWER COMMISSION, *Respondent*.

On Petition for Review of an Order of the
Federal Power Commission

**BRIEF AMICUS CURIAE
OF INDEPENDENT NATURAL GAS ASSOCIATION**

STATEMENT OF THE CASE

On March 20, 1961, the Federal Power Commission (Commission) issued its *Order Determining Rate of Return, Disallowing Proposed Increased Rates, Directing Payment of Refunds, and Permitting Substitution of Lower Interim Rates* in the proceedings at Docket No. G-19780, in the *Matter of Panhandle Eastern Pipe Line Company*, 25 F.P.C. 550.¹ In this order the Commission concluded that a fair

¹ Rehearing denied by order issued May 15, 1961.

and reasonable overall rate of return for Panhandle Eastern Pipe Line Company (Panhandle) was 6.25 percent. This overall return was arrived at, in part, by restating Panhandle's capitalization to include Panhandle's deferred income taxes and by allowing a cost or return of only 1.5 percent on the facilities financed by the deferred income tax accruals.

The deferred income tax accruals in this case amount to \$11,076,954. They represent accumulated amounts attributable to the difference between income taxes that would be paid under normal straight line depreciation and the taxes actually paid since the company has elected to use liberalized depreciation and accelerated amortization pursuant to Sections 167 and 168 of the Internal Revenue Code.² The accumulated deferred income tax accounts will be debited or reduced when taxes become higher than the taxes that would be paid on the same property under normal straight line depreciation.

It is the position of *Amicus*, Independent Natural Gas Association (INGA), that a natural gas company should be permitted to earn the full return on its entire rate base applicable to its jurisdictional business, including the portion of its investment financed by the federal income tax accruals temporarily available as a result of the taxpayer's election to use liberalized depreciation and accelerated amortization permitted by Sections 167 and 168 of the Internal Revenue Code. Stated differently, it is the position of *Amicus* that the Commission should determine the rate of return for a natural gas pipeline company without artificially restating the company's actual capitalization (consisting of long-term debt, preferred stock and common equity) to include deferred income taxes. We believe

² Act of Aug. 16, 1954, C. 736, 68A Stat. 51, 52, 26 U.S.C. §§ 167 and 168. Of the total amount of \$11,076,954 of deferred income tax accruals, \$4,116,859 is attributable to liberalized depreciation and \$6,960,095 results from the taxpayer's use of accelerated amortization.

this result is required by the fact that Congress intended that the benefits of liberalized depreciation and accelerated amortization should go to the taxpayer and not to the rate payer.

Assuming, *arguendo*, however, that a natural gas company may lawfully be deprived of any part of the benefits of liberalized depreciation and accelerated amortization, the Commission must allow, as a very minimum, that return which would place the rate payer in precisely the same position as if the natural gas company had not elected to employ liberalized depreciation and accelerated amortization, but had obtained the same capital through conventional financing and, with the same proportion of debt, preferred stock, and common equity as is presently found in such company's existing capital structure. The application of this principle to the facts of record in this case would result in a minimum return of 5.45 percent on the deferred tax accruals. This is the minimum return which would "neither aid nor harm" the rate payer and which would produce the result sought by Congress under the Commission's own interpretation of this Court's decision in *City of Detroit, Michigan v. F.P.C.*, 97 U.S. App. D.C. 260, 230 F. 2d 810 (1955), cert den. 352 U.S. 829.

In its order which is the subject of the instant appeal, the Commission did not discuss the reasons or considerations claimed to support its determination to allow Panhandle the meager return of only 1.5 percent on its deferred income taxes. It relied entirely upon its Opinion No. 342 (issued March 7, 1961), *Northern Natural Gas Company*, 25 F.P.C. 431, and Opinion No. 343 (issued March 8, 1961), *Kansas-Nebraska Natural Gas Company*, 25 F.P.C. 448. In the *Northern* proceeding, the tax deferrals arose from the taxpayer's election to employ liberalized depreciation. But in announcing the policy which it intended to follow in the *Northern* and future cases, the Commission stated that it was adopting the same view as to all tax accruals. *Id.*,

25 F.P.C. 437. The *Kansas-Nebraska* opinion involved both liberalized depreciation and accelerated amortization. Here the Commission merely followed the *Northern* opinion, *supra*, issued one day earlier, and concluded that the same treatment (that is, a 1.5 percent return) should be accorded to the tax deferrals resulting from the use of accelerated amortization as well as those resulting from the use of liberalized depreciation. For these reasons, frequent references will be made herein to the *Northern* opinion, *supra*.

SUMMARY OF ARGUMENT

The legislative history of Sections 167 and 168 of the Internal Revenue Code clearly demonstrates that Congress intended the benefits of liberalized depreciation and accelerated amortization to go to the taxpayer and not the rate payer. Congress made no distinction between regulated and non-regulated taxpayers. Prior to the instant case, the Commission had repeatedly so declared the Congressional purpose, and held that as a matter of law it was obligated to follow the Congressional mandate and permit the taxpayers regulated by it to retain the benefits of Sections 167 and 168. Such views were squarely affirmed by this Court in *City of Detroit v. F.P.C.*, 97 U.S. App. D.C. 260, 230 F.2d 810 (1955), cert. denied, 352 U.S. 829.³

In the instant case, however, the Commission has reversed itself and has adopted a holding directly contrary to the decision of this Court in *City of Detroit, supra*. The Commission now relies upon a recent opinion, *Northern Natural Gas Co.*, 25 F.P.C. 431, in which it determined that "the major portion of the benefits accruing from the use of liberalized depreciation [and accelerated amortization] should go to the ratepayer, . . ." On this erroneous

³The Commission has concluded that the tax deferrals arising from the taxpayer's use of accelerated amortization and liberalized depreciation should be accorded the same treatment. *Kansas-Nebraska Natural Gas Company*, 25 F.P.C. 448, *supra*.

premise it allowed Panhandle, the petitioner herein, a return of only 1.5 percent on its deferred tax accruals rather than the full return intended by Congress and required by this Court's decision in *City of Detroit, supra*.

The Commission's decision of determining return on the basis of an adjusted capitalization of a natural gas company, including its deferred income taxes, is erroneous for the additional reason that it is the equivalent of a *pro tanto* deduction from the rate base. The exclusion from rate base approach was flatly rejected by this Court in *City of Detroit, supra*, because it would mean that the statute would not be given effect as intended by Congress.

Since Congress intended the taxpayer to receive the full benefits of Sections 167 and 168, a natural gas company should be permitted to earn a *full* return on its entire net investment, including the portion thereof financed by the tax deferrals resulting from the use of the liberalized depreciation and accelerated amortization provisions of Sections 167 and 168.

The Commission apparently construes this Court's decision in *City of Detroit, supra*, as predicated on a "neither aids nor harms" the rate payer rationale. But the Commission did not apply even its own interpretation of such decision of this Court to the circumstances of the instant case. This would have required a minimum return of 5.45 percent on the tax deferrals. Instead the Commission completely rejected this Court's decision in *City of Detroit, supra*, and allowed a return of only 1.5 percent on the tax deferrals, and in this the Commission erred.

The 5.45 percent return on the tax deferrals would under the circumstances of this case leave the rate payer in *status quo*, that is in precisely the same position that he would be in if the taxpayer had not elected to use liberalized depreciation and accelerated amortization. Therefore, assuming *arguendo*, that the taxpayer may lawfully be deprived of any part of the benefits of Sections 167 and 168,

even under the Commission's own interpretation of the rationale of *City of Detroit, supra*, the regulated taxpayer is entitled to earn that minimum return on the tax deferrals which will result in the same annual cost to the rate payer as if the regulated taxpayer had not elected to use liberalized depreciation and accelerated amortization. The intent of Congress in enacting Sections 167 and 168 was to benefit the taxpayer and not the rate payer. This declaration of public policy should be given effect.

ARGUMENT

A. The Commission Erred in Allowing A Return of Only 1.5 Per Cent on Panhandle's Deferred Income Taxes

The deferred income tax accruals in this case amount to \$11,076,954, and they result entirely from the use by the taxpayer of the accelerated depreciation and accelerated amortization provisions of Sections 167 and 168 of the Internal Revenue Code. Prior to the instant case now on review by this Court, the Commission had repeatedly held as a matter of law that both Sections were intended by Congress to benefit the taxpayer and not the rate payer, and that the Commission was obligated to give effect to the clearly expressed Congressional purpose.⁴ *Treatment of Federal Income Taxes As Affected By Accelerated Amortization*, Opinion No. 264, 12 F.P.C. 369 (1953); *Panhandle Eastern Pipe Line Company*, 13 F.P.C. 53 (1954); affirmed on this point by this Court in *City of Detroit v. F.P.C.*, 97 U.S. App. D.C. 260, 230 F. 2d 810 (1955), cert. den. 352 U.S. 829; *Amere Gas Utilities Co., Inc., et al.*, 15 F.P.C. 781 (1956); *Amendment of Uniform System of Accounts Prescribed For Natural Gas Companies Respecting Treatment of Deferred Taxes On Income*, 19 F.P.C. 826 (1958); *El Paso Natural Gas Company*, 22 F.P.C. 260 (1959), affirmed

⁴ As previously noted, the Commission draws no distinction between the tax accruals resulting from the use of liberalized depreciation (Section 167) and those resulting from accelerated amortization (Section 168). See *Kansas-Nebraska Natural Gas Company*, 25 F.P.C. 448.

in so far as here material in *El Paso Natural Gas Co. v. F.P.C.*, 281 F. 2d 567, (CA 5, 1960) cert. den. 81 S.Ct. 1083. We fail to see how the same statutory provisions, without amendment by Congress, abruptly and suddenly may now contemplate, much less require, that "the major portion of the benefits accruing from the use of liberalized depreciation should go to the rate payer, . . ." as the Commission concluded in *Northern Natural Gas Company*, 25 F.P.C. 431, and on which the Commission relies.

In Opinion 264, 12 F.P.C. 369, *supra*, the Commission stated, with reference to the rate-making treatment to be given tax deferrals resulting from the use of accelerated amortization (Section 168) by the regulated taxpayer:

"This Commission is an agency of Congress created to perform certain legislative functions which Congress has delegated to us. We have a legal and moral obligation to abide by and execute the laws of Congress. This obligation does not permit us to substitute our judgment for that of the Congress or nullify the clear Congressional intent by administrative action." (*Id.*, 372)

In *Amere Gas Utilities Co., Inc., et al.*, 15 F.P.C. 781 (1956), *supra*, the Commission announced, for the first time, the effect to be given to Section 167 for rate-making purposes. In setting forth its views the Commission there stated (p. 782):

"Admittedly, section 167 of the Internal Revenue Code contains no specific mandate to create a reserve account for the deferred taxes. Nevertheless, we know of no way to effectuate the clear and obvious Congressional intent, except by doing so, just as we did in our two prior opinions above mentioned.⁵ The argument

⁵ The two prior opinions related to Section 168, accelerated amortization. They are designated, *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 F.P.C. 369 (1953), and *Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53 (1954), affirmed on this point by this court in *City of Detroit v. F.P.C.*, 97 U.S. App. D.C. 260, 230 F. 2d 810 (1955), cert. denied 352 U.S. 829.

that the sums in the reserve account will rightfully belong to the rate payers, or that the rate payers will bear any burden they do not now bear, by reason of the creation of the reserve, is wholly erroneous, as was lucidly explained by the United States Court of Appeals for the District of Columbia, above cited . . .” [City of Detroit v. F.P.C., 97 U.S. App. D.C. 260, 230 F.2d 810]

In the subsequent rate case involving *El Paso Natural Gas Company*, 22 F.P.C. 260 (1959), the Commission again clearly held that it was obligated to give effect to the Congressional intent that Section 167 was to benefit the taxpayer and not the rate payer. In summarizing the legislative history of Section 167, the Commission stated (22 F.P.C. 266):

“The purpose of Section 167 is expressed in the legislative history of the 1954 Revenue Act which first permitted liberalized methods to be used in computing a ‘reasonable allowance’ for depreciation. Both the House⁷ and Senate Reports⁸ stated that the more liberal depreciation allowances for ‘all segments of the American economy’ should ‘assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living.’ Testimony before the House Committee by representatives of electric, gas and telephone utilities had emphasized how utilities found the previously used straight-line method of depreciation unfair to them particularly in view of the declining value of the dollar.” The reasoning of the Committees of Congress is, we believe, conclusive upon us.

“Furthermore we have already, in effect, decided the question here involved, although not in an actual rate proceeding. In the *Amere* case¹⁰ we affirmed the presiding examiner’s decision that Section 167 of the Internal Revenue Code was comparable to Section 168 dealing with accelerated amortization and that the charging of greater depreciation during the early life of property and the charging of less during the later life operates to create a deferral of income taxes. To carry out the clear Congressional intent, we stated that

an account should be established to which the deferred taxes could be credited. We were not and are not now of the opinion that the account for accumulated deferred taxes would belong to the rate payers. As the United States Court of Appeals noted in the *City of Detroit* case¹¹ with respect to the account for accumulated deferred taxes created in connection with accelerated amortization, the intent of Congress was not to benefit consumers, but to encourage construction. The Court said the solution of this Commission, which called on the consumers to pay 'normalized' taxes while crediting the difference between actual taxes and normalized taxes to an account for accumulated deferred taxes, does not result in higher rates to the consumer; it simply does not reduce them. We concluded in the *Amere* case that we could not strike down an Act of Congress and we must apply Section 167 to the natural gas companies. As stated in our order we would call the situation to the attention of Congress by transmitting copies of the presiding examiner's decision and our order to the Chairman of the Finance Committee of the Senate and Chairman of the Ways and Means Committee of the House, and we did so by our letter dated July 2, 1956. Since that time Congress has not amended the Internal Revenue Code or the Natural Gas Act in this respect, thus affirming our interpretation of its intentions.

⁷ H. Rep. 1337, 83rd Cong. p. 24.

⁸ S. Rep. 1622, 83rd Cong. p. 26.

⁹ Hearings on General Revenue Revision, Committee on Ways and Means, House of Representatives, 83rd Cong. 1st Session, pp. 705-709, 725-730, 734-737 and others.

¹⁰ *Amere Gas Utilities Co., et al.*, 15 F.P.C. 781.

¹¹ *City of Detroit v. F.P.C.*, 230 F. 2d 810 (CA6), certiorari denied, 325 U.S. 829."

The Commission's holding in the instant case is premised on the erroneous conclusion set forth in *Northern Natural Gas Co.*, 25 F.P.C. 431, 439, that the "major portion of the benefits accruing from the use of liberalized depreciation should go to the rate payer . . .". This not only constitutes

a reversal of prior Commission pronouncements which correctly declared the Congressional intent, but more importantly, such holding is directly contrary to the mandate of this Court in *City of Detroit, Michigan v. F.P.C.*, 97 U.S. App. D. C. 260, 230 F.2d 810 (1956) cert. den. 352 U.S. 829, wherein this Court specifically held (p. 272, p. 822):

"This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress."

The Commission's allowance of a rate of return of only 1.5 percent (rather than the full overall return) on the accumulated deferred taxes has the same effect, *pro tanto*, as deducting such accruals from the rate base. The inevitable result of the Commission's action in this case is the deduction of by far the greater part of the total tax accruals of \$11,076,954 from Panhandle's rate base. In the *City of Detroit* case, *supra*, this Court expressly and specifically refused to sanction the very same indirect method of nullifying the Congressional intent. The petitioners in that case contended that the tax deferrals resulting from the use of accelerated amortization should be deducted from the rate base each year. This Court held (97 U.S. App. D.C. 271, 230 F. 2d 822):

"This plan was rejected by the Commission, which concluded, we think correctly, that the intent of Congress reflected in section 124A [now Section 168] is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities. Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit."

There is only a difference in degree between what the petitioners sought of this Court in *City of Detroit, supra*, and what the Commission has done in the order under review. The former sought to deduct 100 percent of the tax accruals from Panhandle's rate base. The Commission would now

deduct by far the greater part of such accruals. We submit that both proposals prevent the taxpayer from receiving the benefit intended by Congress.

In departing from this Court's mandate in *City of Detroit, supra*, the Commission relied upon its then recent opinion in *Northern Natural Gas Company*, 25 F.P.C. 431. The Northern opinion in turn is, in substantial part, predicated upon an erroneous interpretation of the following passage in *El Paso Natural Gas Company v. F.P.C.*, 281 F. 2d 567, 573 (CA5, 1960) cert. denied 81 S. Ct. 1083:

"It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequence of rate regulation."

In the same *Northern* opinion, the Commission then proceeds to quote another excerpt from *El Paso* to the effect that liberalized depreciation produces a tax "saving," apparently implying that such "saving" also should be passed on to the consuming public, under the above language of the Fifth Circuit.

The above quoted language from the Court's opinion refers to percentage depletion and intangible well-drilling costs; which, in the view of the Fifth Circuit, gave rise to actual tax savings. Irrespective of whether *Amicus* concurs in the correctness of this determination, it is indisputably clear that in the second excerpt which expressly pertains to accelerated depreciation, the court was not stating that there was any actual savings of taxes—it already had held that Section 167 operates to create a tax deferral and not a tax savings. It was for this reason that it quoted the word "saving." A fair reading of the entire *El Paso* decision establishes beyond any doubt that the court was not holding or even suggesting that the tax bene-

fits resulting from the use of accelerated depreciation were such a "saving" as should be "passed on to the consuming public," as it held in respect of percentage depletion and intangible well-drilling costs.

Finally, we call attention to the fact that subsequent to the *El Paso* decision of the Fifth Circuit, the Commission reaffirmed its prior determinations that deferred taxes were intended to benefit the taxpayer and that such benefits should not be passed on to the consumer either directly or indirectly. In the *Phillips Petroleum Company* rate case opinion, 24 F.P.C. 537 (1960), issued after the Fifth Circuit's decision in *El Paso, supra*, the Commission categorically rejected a proposal, which, as in its order now under review, would have included the deferred taxes as though they were a part of the company's capitalization and would have permitted a return thereon at less than the full rate of return. The Commission stated (p. 570):

"There was no dispute about these figures, but the staff contended that Phillips actual debt ratio and actual cost of debt should be adjusted to reflect as an interest-free loan an item of deferred Federal income tax liability in the amount of \$19,162,355, arising from the accelerated amortization provisions of Section 168 of the Internal Revenue Code. This would decrease Phillips' cost of debt to 2.76 percent. The examiner refused to make this adjustment, and we agree. The accelerated amortization provisions were to benefit the taxpayer, not the consumers. They represent an advantage bestowed by Congress to encourage the construction of emergency facilities, and we are not authorized to take away this advantage. *City of Detroit v. F.P.C.*, 230 F. 2d 810, 822 (CA DC), *certiorari denied*, 352 U.S. 829. We cannot agree to the exception made by the Michigan Public Service Commission on this point."

Apparently as of the issuance of its *Phillips'* opinion, *supra*, the Commission was not at all of the view that *El Paso, supra*, could be relied upon to nullify the Congression-

al intent that Sections 167 and 168 should benefit the taxpayer and not the rate payer.

We submit, therefore, that the Commission's conclusion and major premise, as expressed in the *Northern* case, *supra*, that "the major portion of the benefits accruing from the use of liberalized depreciation should go to the rate payer, . . ." and its resulting determination that Panhandle should be allowed a return of only 1.5 percent on such deferred income tax accruals are irreconcilable with numerous prior Commission determinations concerning the legal effect which *must* be given to the Congressional intent behind Sections 167 and 168, are directly contrary to the mandate of this Court in *City of Detroit, supra*, and are, therefore, erroneous as a matter of law.

B. A Natural Gas Company Is Entitled to Earn A Full Return On Its Deferred Tax Accruals

The legislative history of Sections 167 and 168 of the Internal Revenue Code clearly demonstrate that Congress intended that the benefits resulting from the use of liberalized depreciation and accelerated amortization should go to the taxpayer and not the rate payer.⁶ As demonstrated at greater length in the previous pages of this brief (*supra*, pp. 6-13), the Commission has repeatedly affirmed that such is the case.

"To carry out the clear Congressional intent, we stated [*Amere*, 15 F.P.C. 781] that an account should be established to which the deferred taxes could be credited. We were not and are not now of the opinion

⁶ H. Rep. 1337, 83rd Cong.; S. Rep. 1622, 83rd Cong.; Hearings on General Revenue Revision, Committee on Ways and Means, House of Representatives, 83rd Cong. 1st Session, pp. 705-709, 725-730, 734-737; Statement of the Chairman of the House Ways and Means Committee, explaining the Bill to the House, Congressional Record, pp. 3222-3223, March 17, 1954. (The remarks of the Committee Chairman in reporting a Bill to the House are in the nature of supplemental Committee Reports and are entitled to the weight afforded formal Committee Reports. *Southerland, Statutory Construction*, 3rd Ed., Vol. I, Sec. 5021).

that the account for accumulated deferred taxes would belong to the rate payers." *El Paso Natural Gas Company*, 22 F.P.C. 260, 266 (1959).

And in *City of Detroit v. F.P.C.*, 97 U.S. App. D.C. 260, 271, 230 F. 2d 810, 822, this Court stated with reference to Section 168:

"This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress."

Furthermore, the Congressional intent to benefit the taxpayer must be given effect and made applicable to "all segments of the American economy"⁷ including, of course, natural gas companies.

"We concluded in the *Amere* case that we could not strike down an Act of Congress and we must apply Section 167 to the natural gas companies." *El Paso Natural Gas Company*, 22 F.P.C. 260, 266 (1959).

There can be no doubt of the fact that Congress was fully informed of the prior Commission determinations concerning the effect to be given the liberalized depreciation and accelerated amortization provisions of Sections 167 and 168 of the Internal Revenue Code.

As previously noted, (*supra*, p. 9) by letter dated July 2, 1956,⁸ the Commission transmitted to the Chairman of the Finance Committee of the Senate, and the Chairman of the Ways and Means Committee of the House, copies of the presiding examiner's decision and the Commission order issued in *Amere Gas Utilities Co.*, 15 F.P.C. 781, in which the Commission concluded that it could not strike down an Act of Congress, and that it must apply Section 167 to natural gas companies just as it had concluded previously with reference to Section 168.

⁷ H. Rep. 1237, 83rd Cong. p. 24; S. Rep. 1622, 83rd Cong. p. 26.

⁸ See *El Paso Natural Gas Co.*, 22 F.P.C. 260, 266 (1959).

Congress took no action to indicate that the Commission's determination of the legislative intent in enacting Sections 167 and 168 was in any manner incorrect or erroneous. It has thus affirmed the Commission's interpretation of its intentions. *Boehm v. Commissioner*, 326 U.S. 287, 292 (1945); *Helvering v. Winmill*, 305 U.S. 79, 83 (1938); *United States v. Shreveport Grain & Elevator Co.*, 287 U.S. 77, 84 (1932); *Panhandle Eastern Pipe Line Company v. F.P.C.*, 232 F. 2d 467 (1956).

On May 16, 1957, a bill, S. 2113, was introduced in the Senate by Senators Magnuson, Jackson, Mansfield, Morse, Murray and Neuberger. This bill would have provided that, in the determination of the rates of electric public utilities subject to the Federal Power Act, the Commission could not include tax deferrals arising as a result of Sections 167 and 168 of the Internal Revenue Code of 1954. This bill was *never* enacted into law.

On August 26, 1957 and September 2, 1958, Congress amended Section 168.⁹ On September 2, 1958, Congress also amended Section 167.¹⁰ But, Congress *did not* make any change in either Section 167 or Section 168 to indicate that the Commission had misinterpreted the Congressional intent in its earlier opinions, orders and rulings. This constitutes implied approval, in a most direct and conclusive fashion, of the Commission's prior interpretation that Sections 167 and 168 were intended to benefit the taxpayer and not the rate payer, and that such legislative intent must be given full effect as applied to natural gas companies. *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U.S. 110, 115 (1939); *United States v. Dakota-Montana Oil Co.*, 288 U.S. 459, 466 (1933); *Panhandle Eastern Pipe Line Company v. F.P.C.*, 232 F. 2d 467 (1956).

⁹ Pub. L. 85-165, § 4, 71 Stat. 414; Pub. L. 85-866, Title I, § 9(a), 72 Stat. 1608.

¹⁰ Pub. L. 85-866, Title I, § 89(b), 72 Stat. 1665.

Since the Congressional intent in enacting Sections 167 and 168 was to benefit the taxpayer, including natural gas companies, the taxpayer should receive all of the intended benefits, and conversely, no part of such benefits should go to the rate payer. The nature of the benefits conferred by Sections 167 and 168 contemplate that any taxpayer, including a natural gas company, be permitted to invest the funds, temporarily available in the form of a tax deferral, and earn a full return thereon. A non-regulated business does not earn less on its investment merely because a portion of such investment has been financed by the use of federal income tax accruals resulting from the use of liberalized depreciation and/or accelerated amortization. It has at least an opportunity to earn the same return on all capital invested in the enterprise. For purposes of Sections 167 and 168 Congress intended that all taxpayers should have the same opportunity. There is no hint in the entire legislative history of these statutory provisions that regulated taxpayers should be treated differently.

Congress intended that the facilities of a natural gas company temporarily financed by the deferred tax accruals should be income producing and that they should be income producing at the same rate as allowed for any other property of the company. Therefore the prescribed rate of return should be applied to the total rate base of the regulated company. No attempt should be made to reduce the regulated company's rate of return by the piecemeal method of allowing a return of only 1.5 percent on that portion of the company's property financed by the deferred tax accruals.

In its opinion in *Northern Natural Gas Company*, the Commission recognized that in *City of Detroit v. F.P.C.*, 97 U.S. App. D.C., 260, 230 F. 2d 810, *supra*, it was "the apparent view of the court . . . that moneys in the deferred tax account were the company's money and that it was entitled to all income produced from such money." 25 F.P.C. 437. However, with reference to this Court's opinion

(*City of Detroit, supra*), and its own prior Opinion in that same case (*Panhandle Eastern Pipeline Company*, 13 F.P.C. 52 (1954)) the Commission further concluded in its *Northern* Opinion, 25 F.P.C. 437:

"The *Panhandle* (*City of Detroit*) case was considered by us shortly after the enactment of Section 168. At that time, neither we nor the courts were fully aware of all of the consequences which would result if moneys in the deferred tax accounts were considered as belonging solely to the company. Thus, the statement in the above quotation from the *City of Detroit* case that to permit the company to use the funds for income-producing purposes would not result in higher rates to the consumer has on more careful consideration been disclosed to be erroneous."

The Commission then sought to buttress its foregoing conclusion in the *Northern* opinion, *supra*, with the argument (which we paraphrase) that when deferred taxes are invested in rate base properties income taxes are higher because of the absence of any interest deductions which would have been available had the same facilities been constructed wholly or partially with debt capital. Consequently, so the argument goes, the cost of service, and therefore, the rates of the natural gas company are higher if the additional facilities are financed from deferred taxes than if financed by other sources of capital giving rise to interest deductions.

We submit that the Commission's analysis (in its *Northern* opinion, *supra*), of this Court's opinion in *City of Detroit, supra*, and its reasoning in relation thereto are subject to several significant infirmities.¹¹

In the first place there is no valid reason why the ratepayers should not pay the natural gas company a full re-

¹¹ The Commission's observation in the *Northern* opinion that it has the duty of adopting rate-making principles which will assure the lowest possible rates is wholly in error. There is a vast distinction between the lowest possible rate and a "just and reasonable" rate within the meaning of the Natural Gas Act. See *City of Detroit v. F.P.C.*, 97 U.S. App. D.C. 260, 230 F.2d 810.

turn on its investment in facilities dedicated to their service irrespective of the source of the invested money. The taxes related to that return are a cost as much as any other item included in the cost of service. *Galveston v. City of Galveston*, 258 U.S. 388 (1921).

Secondly, when this Court handed down its Opinion in *City of Detroit, supra*, it undoubtedly was aware of the obvious fact that non-debt financing results in higher taxes because of the absence of interest deductions for federal income tax purposes. Contrary to the erroneous assumption made by the Commission in the *Northern* opinion, the brief of the petitioner, filed with this Court in Case No. 12,351, *City of Detroit, supra*, specifically pointed out to this Court that the decision of the Commission in that case would result in the consumer paying income taxes without interest deductions on that part of the return related to the rate base financed by the deferred tax accruals. (Pp. 95-96 of Initial Brief of City of Detroit.) Furthermore, there are compensating advantages to rate payers in keeping the company's debt ratio relatively lower and the equity ratio correspondingly higher. This has been recognized by the Commission on many occasions. In the recent *Southern Natural Gas Company* rate case, 24 F.P.C. 26 (1960), the Commission stated (p. 30):

"... we have consistently held the public interest is best served by allowing a return on equity which encourages such conservative [higher equity] financial structures."

The tax effect of financing the additional investment with deferred tax accruals would be the same as if financed with equity funds. There would be no tax deductions for interest in either event.

Not only this Court, but Congress also had to be aware of the fact that there would be no interest cost applicable to the deferred taxes intended to be invested in income producing properties. Thus Congress not only knew, but in-

tended, that the earnings from the facilities thus financed, whether of a regulated or non-regulated business, would be taxed at a higher rate than earnings from facilities financed in whole or in part with interest bearing debt capital. Nevertheless, Congress intended and provided in the Internal Revenue Code that any advantages from tax deferrals arising from the use of liberalized depreciation and accelerated amortization accrue to the taxpayer, for in no other way could Congress achieve the avowed purpose of stimulating the national economy through investment by industry in income producing properties.

This Court was fully cognizant of all the foregoing considerations when it handed down its decision in *City of Detroit, supra*, in which it squarely held that to deduct the deferred tax accruals from Panhandle's rate base would deprive that regulated taxpayer of the benefits which Congress intended to bestow upon it. An allowance of anything less than the full return is the equivalent of a *pro tanto* deduction from the rate base. This Court's decision in *City of Detroit, supra*, requires the conclusion that a natural gas company is entitled to earn a full return on its net investment financed by deferred tax accruals temporarily available as a result of the liberalized depreciation and accelerated amortization provisions of Sections 167 and 168 of the Internal Revenue Code.

C. Assuming, Arguendo, That a Natural Gas Company May Lawfully Be Deprived of Any Part of the Benefits of Deferred Taxes, the Commission Erred in Failing to Allow Panhandle That Minimum Return Which Would Result in the Same Annual Cost to the Rate Payer as if the Natural Gas Company (Panhandle) Had Not Elected to Take Advantage of Liberalized Depreciation and Accelerated Amortization.

In the foregoing section of this brief (*supra*, p. 2), we have urged upon the Court the view that a natural gas company is entitled to earn a full return on all of its investment in income producing property subject to the jurisdiction of the Commission, including the portion thereof financed by federal income tax accruals temporarily avail-

able to the taxpayer by reason of the liberalized depreciation and accelerated amortization provisions of Sections 167 and 168 of the Internal Revenue Code. We believe that the allowance of such full return accords precisely with the legislative intent of Congress in enacting Sections 167 and 168, is in conformity with the prior decisions of the Commission, and is required by the mandate of this Court in *City of Detroit v. F.P.C.*, 97 U.S. App. D.C. 260, 230 F. 2d 810 (1955), cert. den. 352 U.S. 829.

In its Opinion in the *Northern* case, however, the Commission placed considerable emphasis on that part of this Court's opinion in the *City of Detroit* case, *supra*, in which the Court stated (97 U.S. App. D.C. 272, 230 F. 2d 822):

"Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress."

And in rejecting the contention that *Northern* should be allowed a full return on its tax deferrals the Commission stated in the *Northern* case (25 F.P.C. 438):

"Since use of liberalized depreciation without either deducting the accrued tax deferrals from the rate base, or taking them into consideration in fixing a rate of return requires the rate payer to pay more than he would be required to pay if liberalized depreciation were not used, we must reject the company's position."

Thus the Commission clearly interpreted the rationale of this Court's holding in *City of Detroit*, *supra*, to require that rate of return on deferred tax accruals which "neither aids nor harms" the rate payer. The application of that rationale, if adopted by the Commission, to the circumstances of this case would have required a return of 5.45 percent. But the Commission did not apply even its own interpretation. Instead it completely rejected this Court's

decision in *City of Detroit, supra*, and adopted the principle that the major portion of the benefits accruing from the use of liberalized depreciation or accelerated amortization should go to the rate payer. (25 F.P.C. 439).

We respectfully submit that *City of Detroit, supra*, even if interpreted to require a result which "neither aids nor harms" the rate payer cannot be construed as permitting a return on the investment represented by the deferred tax accruals to be less than that required to prevent the rate payer from paying more than he would be required to pay if liberalized depreciation and/or accelerated amortization were not used. As applied to the facts of record in this case, such return would not be less than 5.45 percent. This is the percent return which would result in precisely the same annual cost to the rate payer as would obtain if Panhandle had not elected to take advantage of liberalized depreciation and accelerated amortization, but had raised the same amount of capital by the issuance of debt, preferred stock, and common equity in the same proportions and at the same cost and return as the company's actual existing capitalization.

The Commission's determination of a 1.5 percent return on the deferred tax accruals distributes to the rate payer the major part of the benefits resulting from the use of liberalized depreciation and accelerated amortization and is, therefore, completely in conflict with the Commission's own express concession that these statutory provisions are not intended to benefit consumers directly. *United Fuel Gas Co.*, 23 F.P.C. 127, 131 (1960) affirmed sub nomine *Cities of Lexington, et al., v. F.P.C.*, 295 F. 2d 109 (CA 4, 1961). It also violates the mandate of this Court in *City of Detroit, supra*, (97 U.S. App. D.C. 272, 230 F. 2d 822) wherein this Court specifically held:

"This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a definite public policy and should be given effect as intended by Congress."

On the other hand, the 5.45 percent rate of return, as discussed in this section of our brief, permits the natural gas company to retain most of the benefits resulting from the use of liberalized depreciation and accelerated amortization while keeping the rate payer in *status quo*.

Therefore even assuming, *arguendo*, that it is lawful and proper to deprive a natural gas company of any part of the benefits of liberalized depreciation and accelerated amortization and to allow such company less than a full return on its deferred tax accruals, as shown above, the *minimum* return which such natural gas company should be permitted to receive on the deferred tax accruals even under the Commission's interpretation of *City of Detroit, supra*, is that which will result in the same annual cost to the rate payer as if such company had not elected to take liberalized depreciation and accelerated amortization.

CONCLUSION

Independent Natural Gas Association, *Amicus* herein, respectfully submits that the *Order Determining Rate of Return, Disallowing Proposed Increased Rates, Directing Payment of Refunds, and Permitting Substitution of Lower Interim Rates* of the Federal Power Commission, issued March 20, 1961, should be reversed and remanded, with direction insofar as it allows only a 1.5 percent return on deferred taxes, because the law as properly interpreted by this Court in *City of Detroit, v. F.P.C.*, 97 U.S. App. D.C. 260, 230 F. 2d 810 (1955), cert. den. 352 U.S. 829, requires the conclusion that any natural gas company, including Panhandle Eastern Pipe Line Company, should be permitted to earn the full return on its investment including the portion thereof financed by the federal income tax deferrals temporarily available for that purpose pursuant to the liberalized depreciation and accelerated amortization provisions of Sections 167 and 168 of the Internal Revenue Code of 1954.

It is respectfully submitted that as a very minimum a natural gas company, including Panhandle Eastern Pipe Line Company, should be permitted to earn such return as would result in precisely the same annual cost to the rate payer as would be incurred if the natural gas company had not elected to employ liberalized depreciation and accelerated amortization but had raised the same amount of capital by the issuance of debt, preferred stock, and common equity in the same proportions, and at the same costs and return, as such natural gas company's actual existing capital structure.

Respectfully submitted,

/s/ LAWRENCE H. GALL
918 Sixteenth Street, N. W.
Washington, D. C.
*General Counsel for
Independent Natural Gas
Association*

United States Court of Appeals
for the District of Columbia Circuit

FILED DEC 14 1962

Brief of Public Service Commission of Wisconsin
as amicus curiae

CLERK

In the

United States Court of Appeals
For The District of Columbia Circuit

No. 16479

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent,

ON PETITION TO REVIEW AN ORDER
OF THE FEDERAL POWER COMMISSION

WILLIAM E. TORKELSON
*Chief Counsel, Public Service
Commission of Wisconsin*

*Attorney for Public Service
Commission of Wisconsin, amicus curiae*

December 1962.

One West Wilson Street
Madison, Wisconsin

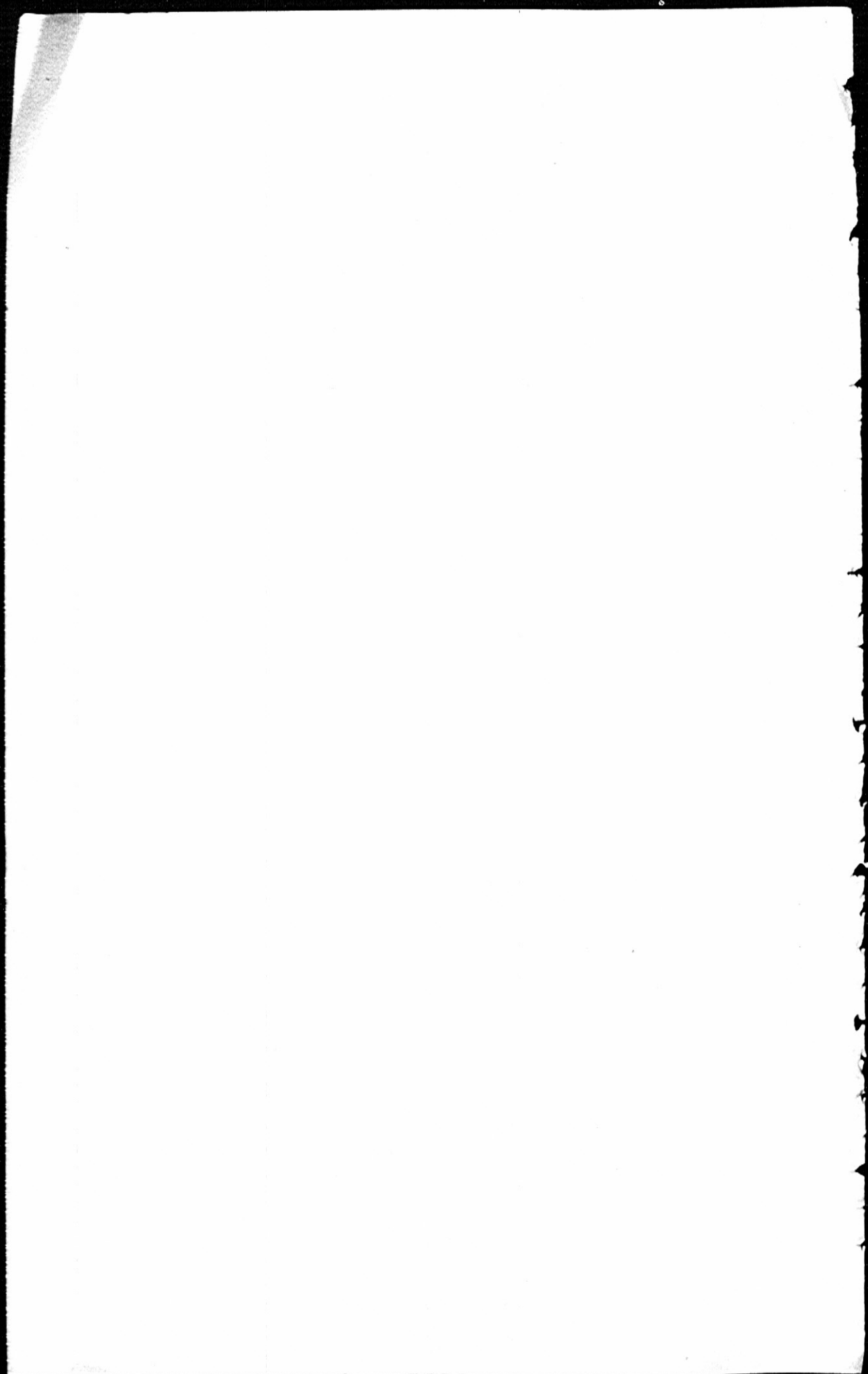
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United States Court of Appeals
for the District of Columbia Circuit

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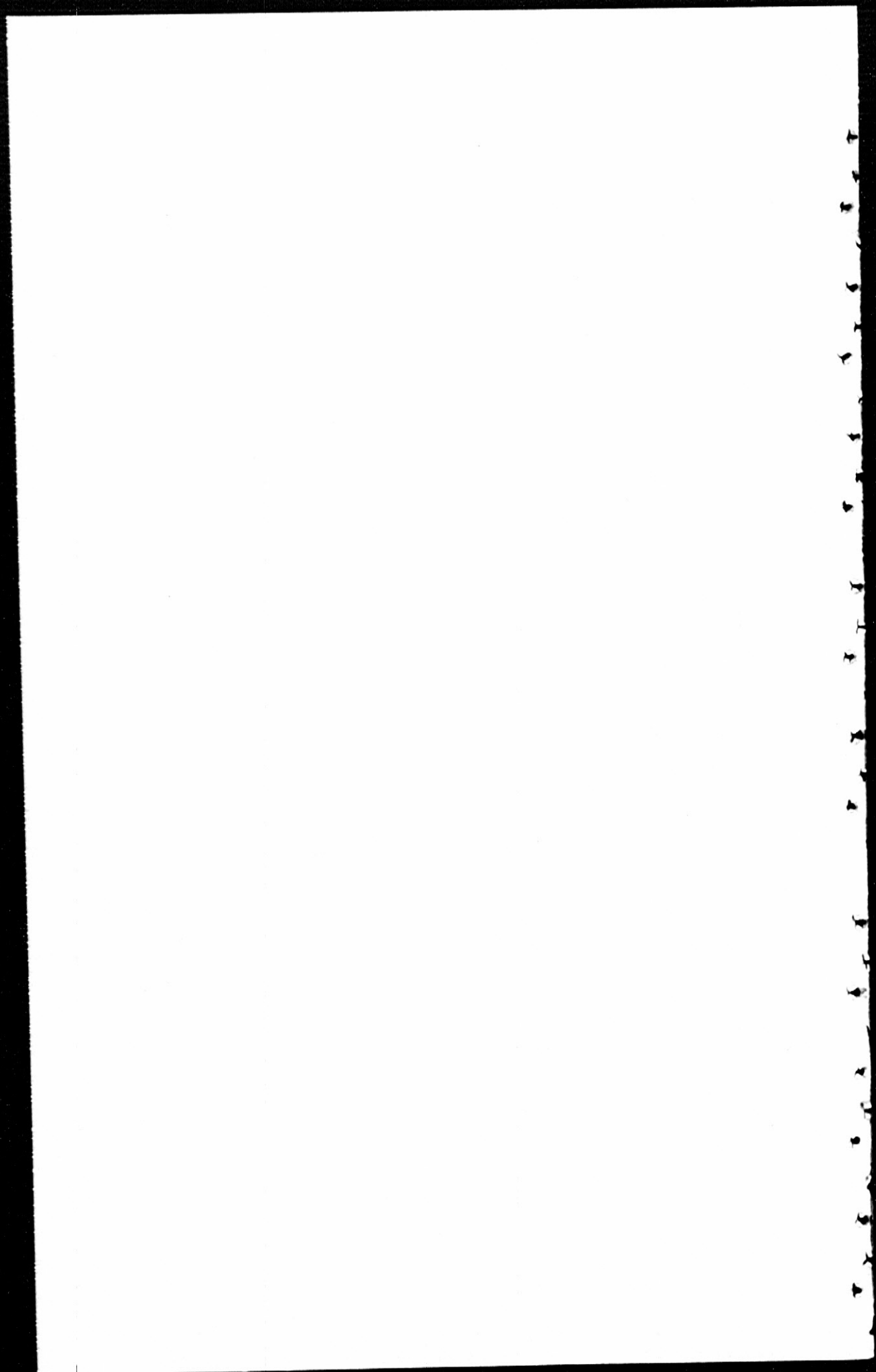
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In the
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PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent,

**ON PETITION TO REVIEW AN ORDER OF
THE FEDERAL POWER COMMISSION**

**BRIEF OF PUBLIC SERVICE COMMISSION
OF WISCONSIN AS AMICUS CURIAE**

By order dated November 20, 1962 the Court has granted the motion of the Public Service Commission of Wisconsin for leave to file a statement or brief *amicus curiae* in the above captioned cause. This brief is in response to the privilege thus granted.

In summary, we take the position that (1) *City of Detroit v. Federal Power Comm.*, 97 U.S. App. D.C. 260, 230 F.2d 810, certiorari denied 352 U.S. 829, should not be considered a precedent in this case; (2) Congressional intent in enacting Sections 167 and 168 of the Internal Revenue Code of 1954 (26 U.S.C. 167, 168) do not justify

the award of any monetary allowance to a regulated company resulting from use of liberalized depreciation under Section 167 or accelerated amortization under Section 168; (3) that the awarding of any such monetary allowance would be contrary to established principles of utility regulation.

The specific issue before the Court on rehearing concerns the treatment which the Federal Power Commission (FPC) should give in determining "just and reasonable" rates as provided in §§ 4 and 5 of the Natural Gas Act (15 U.S.C. 717c and 717d) respecting a reserve of \$11,076,954 accumulated in an account entitled "Accumulated Deferred Taxes on Income" as a result of Panhandle Eastern Pipe Line Company (Panhandle) electing to or being permitted to use liberalized depreciation under § 167 and accelerated amortization under § 168 of the Internal Revenue Code of 1954 and FPC accounting regulations pertaining thereto.

The mandate of the Court following the majority opinion issued in the above captioned cause on September 27, 1962 provides that the order of the FPC under review which permitted Panhandle to earn a return of 1.5% on said reserve, be set aside and the case remanded to it with directions to enter an order allowing Panhandle "the full benefit of liberalized depreciation and accelerated amortization." By the latter it is assumed that such mandate would permit Panhandle a full return, somewhere in the neighborhood of 6% or slightly over, on the aforesaid reserve of \$11,076,954.

The principle involved is of tremendous importance. The decision in this case will not only provide a directive

for the FPC to follow in other cases before it, but it also can provide a precedent for other regulatory agencies and courts.

Further, if the decision in the instant case is allowed to stand and is followed, it would permit regulated companies to earn a full return on capital supplied by rate payers. This means higher wholesale rates for natural gas companies and higher retail rates for ultimate consumers, all other factors remaining equal. The dollar amounts involved are tremendous. The approximately \$11 million reserve of Panhandle involved here involves \$4,116,859 attributable to liberalized depreciation taken under § 167 of the Internal Revenue Code of 1954 and \$6,960,095 under § 168. The more important question involved here is under § 167 since, as pointed out by the Court (slip opinion p. 6 footnote 7), certification under § 168 has terminated. Despite this the situation under § 168, as well as § 167, is important and should receive the attention of the Court.

An indication of the dollar amounts involved in reserves established by natural gas pipeline companies regulated by the FPC resulting from the election of said companies to use liberalized depreciation as provided in § 167 and FPC accounting regulations pertaining thereto, appears in *Re Northern Natural Gas Company* (Opinion No. 342), 25 FPC 431 (1961), where the FPC said, pages 433-4:

"The question of the proper treatment, in fixing rates of return, of amounts accumulated in a deferred tax account by reason of a company's election to use liberalized depreciation, as provided in Section 167 of the Internal Revenue Code, has not yet been determined by

us. The increasing importance of this question is indicated by the extent of these tax accruals. In Northern's case, as shown above, they amount to in excess of eight million dollars. Based on reports by the companies to the Commission, it appears that the amount of such accruals in the year 1959 by natural-gas pipeline companies subject to Commission jurisdiction aggregates some \$39,000,000; and total accruals by such companies to date approach \$110,000,000. * * *

The \$110,000,000 was as of March 7, 1961 and related, as we understand it, to the situation arising from use of liberalized depreciation under § 167, not including any reserve created from the right to use accelerated amortization under § 168. Also, it can be assumed the \$110 million figure will have increased in the year and a half that have elapsed since March 1961. This is supported by data in the petition of the FPC for rehearing herein pp. 13-14 which give figures showing the increase in the amounts involved.

ARGUMENT

1. *The majority opinion assumes the City of Detroit Case is controlling in the instant case with respect to the portion of the reserve attributable to § 167 as well as § 168.*

In arriving at the conclusion that Panhandle is entitled to the full benefit of liberalized depreciation and accelerated amortization the majority assumes *City of Detroit v. Federal Power Comm.*, 97 U.S. App. D.C. 260, 230 F. 2d 810 (1955), certiorari denied 352 U.S. 829, is applicable and controlling with respect to the portion of the reserve

attributable to § 167 as well as § 168. We respectfully submit this is an incorrect assumption.

The *City of Detroit Case* was decided under § 124A of the Internal Revenue Code of 1939 as amended. It (§ 124A) subsequently became § 168 of the Internal Revenue Code of 1954. However, this provision relates to accelerated amortization, which differs from liberalized depreciation permitted under § 167. We assert for reasons hereinafter given (pages 14-19, *infra*) *City of Detroit* should not be accepted as a precedent even under § 168. But even if this is incorrect, which we deny, in any event *City of Detroit* would apply in this case only insofar as the \$6,960,095 portion of the reserve in question arising from use of accelerated amortization under § 168 is concerned, and not to the \$4,116,859 portion of the reserve which arises from use of liberalized depreciation as provided in § 167 of the Internal Revenue Code of 1954. The latter is an entirely different statute than § 168, has different provisions and, as we point out pages 11-14, *infra*, has different legislative history and purpose.

In considering the problem involved it is essential at all times to keep in mind the differences in §§ 167 and 168 of the Internal Revenue Code of 1954 and their different legislative history and purposes. Further, it should be re-emphasized that the real regulatory problem presented is with respect to the situation under § 167 rather than under § 168, for the reason that as stated in the majority opinion (slip opinion p. 6 footnote 7) certification under § 168 has been terminated. See Section 168 (i), Internal Revenue Code of 1954 as amended.

2. *The City of Detroit Case should not be accepted as a precedent with respect to the problem presented under either § 167 or 168 of the Internal Revenue Code of 1954.*

The provisions of §§ 167 and 168 are dissimilar and have a different effect. Essentially § 167 is a general statute which affords every taxpayer having certain depreciable property to compute depreciation for federal income tax purposes by the straight-line method, declining balance method, sum-of-the-years-digits method, or any other consistent method meeting certain qualifications.

On the other hand, § 168 permits a person having an "emergency facility" as defined therein to take for federal income tax purposes an "amortization deduction" computed on basis of a 60-month period for the specific facility involved, provided such person had a certification from the appropriate agency designated by the President by Executive Order. No certification under subsection (3) could be made with respect to any emergency facility until after December 31, 1959. Section 168 (i), Internal Revenue Code of 1954, as amended.

The enactment of the foregoing federal income tax provisions immediately presented problems respecting their application in case of regulated companies. The FPC considered the matter and first adopted accounting directives which established a new account for regulated companies electing to use liberalized depreciation under § 167 or certified to use accelerated amortization under § 168, known as Account 266 (redesignated Account No. 281 effective January 1, 1961) entitled "Accumulated Deferred

Taxes on Income." See Order No. 171, 13 FPC 968 (1954); Order No. 203, 19 FPC 826 (1958); *Northern Natural Gas Co.* (Opinion No. 342), 25 FPC 431, 434.

We do not attempt to go into the merits of the FPC decision or decisions in adopting such accounting directives.¹ Having adopted such a procedure, the problem now involved and which the Court must decide is the proper treatment of the amounts represented in such account for rate making purposes. The solution of this problem requires a discussion of the source of capital in such a reserve as well as its ultimate use.

- a. *The accruals arising from the use of liberalized depreciation under § 167 or accelerated amortization under § 168, Internal Revenue Code, represent cost-free capital to the regulated company.*

There can be no reasonable doubt but that the accruals in question are cost-free capital available to the regulated company which capital is provided by the rate payers. Such accruals are obtained by the regulated company by charges to operating expense, representing the difference between the amount of federal income taxes actually paid by use of liberalized or accelerated amortization as provided in § 167 or 168, as the case may be, and the amount such taxes would have been had they been computed by using straight line depreciation. Since by this procedure an amount greater than actual taxes is charged against operating expense, it is evident that the cost of service

¹ For a recent article concerning the manner in which various courts and regulatory commissions have handled the problem resulting from the privileges permitted by Sections 167 and 168, Internal Revenue Code of 1954, being followed in case of regulated companies, see 28 U. Chicago L.R. 629 (1961). Also for recent case adopting the "flow through" theory see *Cincinnati Gas & E. Co. v. Public Utilities Comm.*, ____ Ohio St. ____, 184 N.E. 2d 84 (1962).

is increased by a corresponding amount, resulting in a higher rate which must be paid by consumers for gas. Thus, the accruals in question are *not supplied by investors*, but rather by the rate payer through rates which are higher than would otherwise be required if such accruals were not being accumulated and maintained by the company.

- b. Use of liberalized depreciation as provided in § 167 in the case involving a normal regulated company, results in a tax saving and not a tax deferral.*

In the majority opinion in the instant case it is stated, *inter alia*:

"It is thus seen that accelerated amortization or liberalized depreciation produces only temporary tax savings: a portion of the tax payments which would be due in the early years under straight-line depreciation is merely deferred until the later years. * * *"

The above statement should be re-examined. Actually it is correct in case of accelerated amortization under § 168, which involves a specific unit or units of property for which an appropriate authorization has been given to use accelerated amortization. The situation is otherwise in cases involving liberalized depreciation under § 167, except in case of a single unit of property or in case of a dying plant. In case of utility plant with numerous units of property where the property continues to grow or even remains static, liberalized depreciation will always be greater than straight line depreciation and all other factors remaining constant, a tax saving results. See Report of the Committee

on Accounts and Statistics, National Association of Railroad and Utilities Commissioners (Report of 67th Annual Convention 1955) (hereinafter referred to as NARUC Committee Report)), pp. 439, etc. and authorities cited therein; *Amere Gas Utilities Company* (decision by Presiding Examiner Marsh), 15 FPC 760, 772-3; dissenting opinion by Commissioner Connole in *Amere Gas Utilities Co.*, 15 FPC 760, 783-5, and in *United Fuel Gas Co.*, 23 FPC 127, 145; Sidney Davidson, "Accelerated Depreciation and the Allocation of Income Taxes," in *The Accounting Review*, April 1958, p. 173; Note, 69 *Harvard Law Review* 1096, 1101-3. In the NARUC Committee report, *supra*, it is said, page 439-40:

"Although it can be shown for a single unit of property that the higher annual charges for liberalized depreciation in the early years of life will be followed by reduced charges in later years, a different picture is presented when the procedure is applied to property comprised of a large number of units as is characteristic of utility plant. Under these conditions, liberalized depreciation will continually result in annual charges higher than the usual straight-line method if the plant continues to grow; and even if the plant should become static after having attained a stabilized age distribution, the annual liberalized depreciation charges would not be less than those under the straightline method."

The result is that where liberalized depreciation as provided in Section 167 is used, for a public utility plant of numerous units, the federal income tax liability will always be less than the amount of such taxes had straight-line depreciation been used in all cases except where there is a dying plant. In other words, in case of a typical regu-

lated company, use of liberalized depreciation under Section 167 will result in a tax saving and not a tax deferment. The accruals for deferred taxes resulting from use of liberalized depreciation under Section 167 will, in case of the typical utility plant, always be in excess of any charges against it. *Hence, such accrual supplied through rates paid by consumers will be a permanent source of cost-free capital for the regulated company.* See Opinion by Presiding Examiner Marsh in *Amere Gas Utilities Company*, 15 FPC 760, 769, 772-3. In its opinion in that case, the FPC does not dispute this but characterizes the accrual as a "continuing tax deferral." 15 FPC 781, 782. This is an euphemism for "tax saving."

In cases under Section 168 involving an "emergency facility" permitting an amortization deduction as therein provided, there will definitely be a tax deferral. This is true because under Section 168 the amortization period with respect to *a specific facility* is 60 months. Thus in cases falling under Section 168 (a special certification to come under Section 168 being required—see Section 168 (a)) involving a specific facility, the amortization deduction permitted over the 5-year period will reduce the federal income tax as long as such deduction is available, but at the expiration of the 5 years the deduction is no longer available for computing such taxes, and everything else remaining constant, the federal income taxes will go up.

While use of liberalized depreciation under Section 167 will, in case of a typical utility plant, produce a tax saving and use of the 5-year amortization deduction for a specific facility where authorized under Section 168 a tax deferral, it is important to note that in both cases the

result of establishing a reserve for so-called deferred taxes is to provide a source of cost-free capital for the regulated company, the difference being, under Section 167, that such cost-free capital is permanently available to the company, while that provided under Section 168 is for a limited period.

- c. The Congressional intent in enacting Section 167 does not warrant the conclusion that the regulated company is entitled to a return on the portion of the reserve for alleged deferred taxes which may be established.*

The material bearing on the Congressional intent in enacting § 167 establishes, we submit, that there is no basis for the conclusion that a regulated company is entitled to a return on any reserve for alleged deferred taxes which may be established. In the instant case the portion of the amount in the account entitled "Accumulated Deferred Taxes on Income" attributable to use of liberalized depreciation is \$4,116,859.

The intent of Congress in enacting Section 167 is stated in the Committee Reports to accompany H.R. 8300 (House Report No. 1337, 83d Congress 2nd Sess., IX G. Depreciation (Sec. 167) pp. 22-25, and Senate Report No. 1622, 83d Cong. 2nd Sess., IX G. Depreciation (Sec. 167) pp. 25-29), which are printed in Vol. 3, U.S. Code Cong. & Adm. News, 83d Congress, Second Session (1954), House p. 4046-4050, Senate p. 4655-4659; Report 67th Annual Convention, National Association of Railroad and Utilities Commissioners (1955) pp. 510-21.

We think a fair statement is that in enacting Section 167 the Congressional intent was to provide in statutory form so as to avoid any argument, that *any* taxpayer entitled to deduct depreciation expense in computing his federal income tax, could use a method of depreciation other than straight line, and that the incentive for using a liberalized method was that such methods would result in a faster write-off of plant and equipment and provide capital for replacement and expansion as well as working capital, thus expanding industrial capacity with resulting economic growth, increased production and a higher standard of living. For the non-regulated business the only possible incentive is that resulting from the possibility of lowering the cost of doing business, thus enabling it to better compete with others. There is no evidence of any intention to treat a regulated company differently. As one indication of the lack of any intent to treat a regulated company differently or better than other taxpayers is the statement in both the House and Senate Committee Reports that "small business and farmers particularly have a vital stake in a more liberal and constructive depreciation policy." 3 U.S. Code Cong. & Adm. News, 83d Congress Second Session, p. 4048.

Incentives, which are in accord with Congressional intent and are in law sufficient to induce use of liberalized depreciation under Section 167 by a regulated company, are (a) lower federal income tax liability for the indefinite future, thus reducing its costs of doing business and enabling it to compete better with other fuels; (b) possible lower rates to consumers which, in addition to improving the competitive position of the company, also generates

good will; (c) provides large sums of capital at zero cost, reducing the need to go to investors for such amounts.

Significantly, the various other courts which have examined the subject reject the argument that in enacting Section 167 Congress intended to grant a specific monetary reward as an incentive. Thus, in *Central Maine Power Co. v. Maine P.U.C.*, 153 Me. 228, 136 A.2d 726, 21 PUR 3d 321, 333:

"From our reading of § 167 of the Code, *supra*, and the House and Senate Committee reports thereon, to which the company has directed our attention, we are unable to find an intent on the part of Congress that the rate-payers of a regulated utility should provide an interest-free loan to the company through present payment of a deferred tax. We must not read more into the act than reasonably may there be found. 3 U.S. Code Cong. & Adm. News, 83d Congress, Second Session (1954), House p. 4048, Senate p. 4654."

See to same effect: *Re Montana-Dakota Utilities Co.*, ---- N.D. ----, 102 N.W. 2d 329, 33 PUR 3d 531, 540-2 (1960); *City of Alton v. Illinois Commerce Comm.*, 19 Ill. 2d 76, 165 N.E. 2d 513, 33 PUR 3d 76, 84-7 (1960); *Pittsburgh v. Pennsylvania P.U.C.*, 182 Pa. Super Ct. 551, 128 A.2d 372, 17 PUR 3d 249 (1956).

Actually there is strong evidence that in enacting the Internal Revenue Act of 1954 Congress did not intend corporations to receive interest-free loans through accruals of taxes. Thus, Section 6154 of the Internal Revenue Code of 1954 provides that large corporations estimate taxable income and make payments of estimated taxes thereon. The House Committee Report (3 U.S. Code

Cong. & Adm. News, 83d Congress Second Session, p. 4131) states these provisions will greatly assist the treasury in managing the public debt to the least detriment to the money markets and to the extent they speed up collection of revenues, reduce the government's short-term borrowing requirements. On introduction of H.R. 8300 (which became the Internal Revenue Act of 1954) Hon. Daniel A. Reed, Chairman of the House Ways and Means Committee, stated (100 Congressional Record 3222; also reported in U.S. Code Congressional & Administrative News, Internal Revenue Code 1954, statements by Committee Chairmen, p. 18) this "pay as you go" plan for large corporations *was one of the most important features of the bill.*

Under the circumstances it certainly is not logical to ascribe to Congress any intent, through the operation of Section 167, to provide a regulated company with an interest-free loan while at the same time current payment of taxes was speeded up through the operation of Section 6154 so as to reduce interest-free credit from tax accruals.

- d. The Congressional intent in enacting Section 168 likewise does not warrant the conclusion that the regulated company is entitled to a return on the portion of the reserve for deferred taxes here involved resulting from use of accelerated amortization.*

Section 168 was formerly Section 124A, which latter was of course involved in *City of Detroit v. Federal Power Comm.*, *supra*. With respect to the enactment of Section

168 the comment in House Report No. 1337, Senate Report No. 1662, and Conference Report No. 2543 accompanying the Internal Revenue Act of 1954, indicates that Section 168 corresponds to Section 124A, 1939 Code. No substantive change is made. See pp. 4189, 4843, 5280, 1954 U.S. Code Cong. & Adm. News. This section was also amended by Public Law 85-866 and Public Law 85-165. The legislative history and purpose of Public Law 85-165 appears in 1957 U.S. Code Cong. & Adm. News pp. 1610, 1611-2, and for Public Law 85-866 in 1958 U.S. Code Cong. & Adm. News pp. 4791, 4807-8.

A review of the background for what is now Section 168 appears in *United States v. Allen-Bradley Co.*, 352 U.S. 306, 1 L. ed. 347 (1957). It is there pointed out that, in 1940, the defense program required private capital, among other forms of assistance, to provide defense facilities. Business was reluctant to build new war facilities because of fear they would be useless when the emergency was over. In response to such fears Congress amended the 1939 Internal Revenue Code by adding Sections 23(t) and 124 allowing for a write-off of facilities within 5 years or less for income tax purposes upon receiving the necessary certificate. It is stated, p. 348:

“ * * * This accelerated amortization privilege generally enabled those businesses receiving it to reduce their federal income taxes with the net result that a large part of the construction costs was, at least temporarily, borne by the Federal Government through a reduction in its tax receipts.”

The purpose of Section 124A has been stated by one court (referring to legislative history recited by the Tax

Court in 17 T.C. 1208) as being to induce the immediate and large investment of private capital in the acquisition and construction of facilities for production of materials vitally needed for national defense. *Arkansas-Oklahoma Gas Co. v. Commissioner* (CA 8), 201 F. 2d 98 (1953).

The analysis of the legislative history by the Tax Court in *Arkansas-Oklahoma Gas Co. v. Commissioner* (1952), 17 T.C. 1208, relied on by the Court of Appeals in the above case, concludes that Section 124 was intended to aid in the development of national defense in the sense that plant installed to fulfill defense contracts could be rapidly depreciated for federal income tax purposes, while there was still income therefrom to deduct it from. Thus, it is said (17 T.C. 1212):

"A study of the legislative history of section 124 indicates that such section was added to the Code in order to aid in the development of national defense. Industries which had to undergo large expansions in order to fulfill defense contracts were alarmed at the costs of such expansion programs. While such costs would be recoverable over the years by means of depreciation, they were dissatisfied with such treatment since they feared that at the end of the emergency period, when they could again return to peacetime activities, such enlarged facilities would be unnecessary or useless; and while they could still continue to write off depreciation each year, they might not have sufficient income against which to deduct it. The Second Revenue Act of 1940, therefore, added section 124 to the Code in order to speed up the rate of depreciation to coincide with the useful life of such facilities. The hearings before Congress, prior to the enactment of the Second Revenue Act of 1940, are replete with statements indicating that this was the purpose of such enactment; and such legisla-

tive history indicates that the purpose of such provision was to cover deductions normally covered under section 23(1) of the Code."

In 1957 U.S. Code Cong. & Adm. News pp. 1610-2, explanation is given for the amendment in Public Law 85-165 to limit the issuance of rapid amortization certificates, after August 22, 1957, to those for new or specialized defense facilities or research and development facilities for defense and for complete termination of the authority to issue such certificates after December 31, 1959. Among other things, it is said, p. 1611:

"* * * Since 1953 the stated objective of amortization was to encourage the construction of facilities that might be needed in a future war. * * *"

It was pointed out that certificates of amortization had been granted to industries such as electric power and railroads with primarily civilian markets and inequalities that could be created; that the rapid amortization program is very expensive (in the neighborhood of \$3 billion) from the viewpoint of the federal government, and the loss of federal revenue resulting could be offset only by imposing some of the burden on other taxpayers. The amendment would result in the program being limited in the future (p. 1612) "to producing facilities for defense items which are sufficiently new or specialized to require construction of different facilities."

We submit that from the foregoing it can properly be said that in enacting Section 124 (now 168) what was intended was to induce dedication of capital to defense

facilities by giving those taxpayers obtaining certificates the right to amortize, for federal income tax purposes, the cost of defense facilities in a period of 5 years or less, so that the capital invested could be recovered by the taxpayer through lower federal income taxes, while the plant was still producing income from being used for defense purposes. There is not one word indicating any intent to provide any other inducement, such as allowance for a return to regulated company on the capital so obtained. The inducement is the greater assurance of a recovery of the capital invested, not the right to earn an additional amount thereon.

In *City of Detroit v. Federal Power Comm.*, *supra* this Court assumed, *inter alia* that unless the regulated company was permitted to have the accrual for deferred taxes there established, i.e. the aggregate of tax savings resulting as a result of the company being entitled to use accelerated amortization under Section 124A for certain facilities, included in rate base on which it could earn a return, the company could not benefit under Section 124A. Such an assumption was not correct, as we submit the intended benefit (which would still exist by deducting the accruals from rate base or by treating it as capital obtained at zero cost in determining rate of return) is the expectation noted in *Arkansas-Oklahoma Gas Co. v. Commissioner*, *supra*, that accelerated amortization will enable it to recover the capital put in a defense facility from lower federal income taxes resulting therefrom while the facility is still producing income.

In *Public Service Company of New Hampshire v. State*, 102 N.H. 150, 153 A.2d 801 (1959), it is said, page 805:

"Despite the holding of *City of Detroit, Mich. v. F.P.C.* 1955, 97 U.S. App. D.C. 260, 230 F. 2d 810, 822, relied upon by the Companies, the fact is that Congress has not undertaken to provide what effect, if any, section 168 shall have upon rate making. The congressional purpose was accomplished when the Company was encouraged to undertake the construction of facilities deemed 'necessary in the interest of national defense.' See *United States v. Allen-Bradley Company*, 352 U.S. 306, 307, 77 S.Ct. 343, 344, 1 L.Ed. 2d 347; 4 Merten's Law of Federal Income Taxation, *supra*, § 23.128."

It is only fair to say that at the time of its decision in *City of Detroit* in 1955 (certiorari denied in 1956) this Court did not have the benefit of the decision of the Supreme Court in *United States v. Allen-Bradley Co.*, *supra*, decided in 1957.

It is also noteworthy that in *City of Detroit v. Federal Power Comm.*, *supra*, this Court said its solution does not result in higher rates to the customer. Subsequent actual experience has indicated otherwise, according to the statement of the FPC in *Northern Natural Gas Company*, Opinion 342, 25 FPC 431, at page 437:

"The *Panhandle* (City of Detroit) case was considered by us shortly after the enactment of Section 168. At that time, neither we nor the courts were fully aware of all of the consequences which would result if moneys in the deferred tax accounts were considered as belonging solely to the company. Thus, the statement in the above quotation from the *City of Detroit* case that to permit the company to use the funds for income-producing purposes would not result in higher rates to the consumer has on more careful consideration been disclosed to be erroneous."

- e. Actually the FPC has no power to award any amount to a regulated company arising from its use of liberalized depreciation under Section 167 or accelerated amortization under Section 168. Its power is limited to fixing a "just and reasonable rate."*

On basis of the foregoing analysis of Congressional intent, we respectfully submit there is no indication of any Congressional intent either under § 167 or 168 justifying the allowance of any return on the amount represented by the reserve in the account entitled "Accumulated Deferred Taxes on Income" here involved.

Actually, we submit, the FPC has no power to award any amount, whether denominated an "incentive" or "return" or what not, to a regulated company arising from its use of liberalized depreciation under § 167 or accelerated amortization under § 168. Of course, as previously pointed out, the right to use accelerated amortization under § 168 is not open to every taxpayer as is liberalized depreciation under § 167, but is available only under the specific circumstances mentioned in § 168.

We point out that the only statute under which the FPC can act and the only statutory standards under which it has jurisdiction to act in this class of case is to determine a rate that is "just and reasonable." Section 4, 5, Natural Gas Act. It has been delegated no power to administer the tax laws nor to determine how many dollars, if any, should be awarded to a natural gas company if it elects to adopt a liberalized method depreciation under § 167 or is entitled to use accelerated amortization under § 168, or any other tax statute. If any allowance is made

to a regulated company as a result of its use of liberalized depreciation under § 167 or accelerated amortization under § 168, it in fact represent additional dollars of profit or return. Under its power to fix "just and reasonable" rates the FPC by well established principles must confine itself to the allowance of no more than a "fair return." It has no lawful power to allow more.

There is, in any event, no standard provided in §§ 167 and 168, or any where else, under which the FPC could measure and fix the amount of any allowance to a regulated company in this or any other case involving a specific natural gas company resulting from use of liberalized depreciation or accelerated amortization in excess of a fair return. Hence, if it is held that the FPC must fix and award some amount to be awarded to a regulated company resulting from its use of liberalized depreciation or accelerated amortization, there is, we submit, no statutory standard provided which indicates what measure should be used in arriving at such determination. This would, we submit, require the FPC to exercise a power which, if put into effect, would constitute an unconstitutional delegation of legislative power contrary to Art. I, Section 1 and Art. I, Section 8, paragraph 18 of the United States Constitution. See tests in *Panama Refining Co. v. Ryan*, 293 U.S. 388; *Brannan v. Stark*, 342 U.S. 451, 464-5.

In *El Paso Natural Gas Co. v. Federal Power Comm.* (CA 5), 281 F. 2d 567 (1960), certiorari denied 366 U.S. 912, the Court of Appeals, referring to Section 167 of the Internal Revenue Code of 1954 as well as the percentage depletion allowance and intangible well drilling allowance, stated, p. 571:

"We thus come to the question: What effect must the Commission give to the tax incentives provided by Congress for the gas industry, as relates to the percentage depletion and intangible drilling expense items and to taxpayers generally, as relates to the rapid depreciation item in arriving at a just and reasonable rate?"

"We think that full effect must be given to the Congressional intent to make the several tax savings available to this taxpayer either because it is in the natural gas business or because it is acquiring new equipment subject to the depreciation options of the 1954 Act.

"We think, however, that this does not mean that these tax benefits are to be translated into additional profits for the regulated company over and above a reasonable return on its investment. They are available to the regulated companies to make it so much the easier for them, in competition with other fuels and in competition with other industries seeking the investor's dollar to earn a fair return, *including* the substantial increment of incentive for exploration and development and payment for gas consumed."

In answer to the contention by El Paso that it was entitled to keep tax benefits granted by the tax statutes involved, including Section 167, over and above an amount representing a reasonable return on investment, it was said by the Court of Appeals for the Fifth Circuit that, "We hold this does not follow." Referring to the intent of Congress that the sale of gas be regulated to prevent rates that are not just and reasonable and to certain requirements necessary to provide a just and reasonable rate, the Court continued, p. 572:

"• • • The requirement that the Commission determine a just and reasonable rate is not modified by reading into the statute an exception to the extent that the prices

charged may be sufficient to afford a just and reasonable rate *plus* an amount representing a savings in taxes granted to the gas industry. We think there is nothing in the legislative history that would warrant our concluding that Congress intended the statutory depletion, deduction of intangible drilling expense, and rapid depreciation provisions of the Revenue laws to amend or modify the express language of the Natural Gas Act, ..."

The Court then quoted Section 5(a) of the Natural Gas Act and continued, p. 573:

"We think, in short, that there is no statutory authority for the Commission to treat actual savings in taxes to which natural gas companies are entitled any differently than savings in any other cost of service. It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequence of rate regulation."

Then it is said, pp. 573-4:

"The one exception, *if it be an exception*, is the treatment to be afforded the tax saving or deferral resulting from the use by the taxpayer of the declining balance of depreciation of new equipment. In practical effect this works a tax deferral rather than a tax savings². If the company were charged for rate making purposes with such 'savings' during the year in which the de-

² This is a correct assumption where a single unit of property is involved. It is not a correct assumption in a case where there is a growing or static plant comprised of numerous units of varying lives, which is the case of regulated companies in all situations except where they are in a dying condition. See NARUC Committee Report, p. 9, *supra*.

preciable assets were acquired, and the rate resulting from such treatment of the taxes was thereafter used for later years, as is here the case, it is clear that the company would be paying higher taxes in subsequent years than in the test year, but would not be entitled to an adjustment in rates to cover the increase. Therefore, we approve the Commission's treatment of the 'saving' resulting from using the declining balance method of depreciation for tax purposes but computing its taxes for rate-making purposes on the straight line method of depreciation, placing such 'savings' in a special reserve to be used to equalize tax payments in later years. *These amounts can never represent added return to the company because of the restriction as to their use.* (Emphasis ours)

"Nothing here decided prevents the commission from giving consideration to the legislative history which resulted in these tax benefits as an aid to it in determining what figure must be used to assure the petitioner of a sufficient rate to compensate it for its depletion of gas and as an incentive to attract capital to this industry."

In the recent case of *Lexington v. Federal Power Comm.* (CA 4), 295 F. 2d 109 (1961), the Court of Appeals for the Fourth Circuit said it was not concerned in that case with whether the "tax deferral fund" should be included in rate base. It did quote some of the material above quoted from *El Paso Natural Gas Co. v. Federal Power Comm., supra*. In addition, in discussing the treatment to be given the provisions in the federal income tax law relating to percentage depletion and intangible well drilling allowance, the Court of Appeals for the Fourth Circuit, *inter alia*, rejected the conclusion of the FPC that if the tax savings resulting from these provisions exceeded

the "fair return" it (the FPC) would be required to allow the company to retain the full tax savings. The Court said:

"In reaching this conclusion the Commission, in our opinion, was in error since it focused its attention upon the tax statutes and lost sight of the broad responsibility imposed upon it by the Natural Gas Act, for it indicated that in a certain contingency it would be obliged by the tax statutes to give to the utility a greater return than the just and reasonable return to which the utility is restricted by the regulatory act. Here also we are in accord with the conclusion reached in *El Paso Natural Gas Co. v. Federal Power Commission*, 281 F. 2d 573, where the Commission allowed the utility more than a fair return because of the statutory tax benefits. In condemning this action the Court said:

'It is the duty of the Commission to fix a rate that represents the cost of service and a reasonable return on the investment, including compensation for consumption of the gas and an increment for incentive, instead of merely treating the tax savings as the amount necessary to provide for return and incentive. This can be done only by making the necessary inquiry directed to this issue, building up a proper record, and making findings on the amount actually necessary to provide these items.'"

The above, we submit, compels the conclusion that whatever the intent of Congress in enacting §§ 167 and 168, the FPC has no power to award any allowance in excess of a fair return when it is determining a "just and reasonable" rate under Section 4 or 5 of the Natural Gas Act. In addition, we deny any intent by Congress in enacting these sections to provide that a regulatory agency award a specific monetary amount, such as an allowance of a return on any accrual in any account entitled "Ac-

cumulated Deferred Taxes on Income", for so-called deferred taxes, to induce it to adopt either liberalized depreciation under § 167 or to seek permission to use accelerated amortization under § 168, or for any other reason.

3. *On principle, a regulated company should not be permitted to earn a return on capital not supplied by investors. This principle has been recognized in denying a regulated company any return on a reserve for alleged deferred taxes under Section 167.*

We have pointed out (pages 7, 8, *supra*, that the accruals arising from use of liberalized depreciation under § 167 or accelerated amortization under § 168 represents cost-free capital for the regulated company. It further appears, we submit, (pages 11-26, *supra*) that neither the Congressional intent in enacting these sections, nor any thing else, justifies the allowance of any return on the capital on such accruals for benefit of the regulated company. To hold otherwise, we submit, would not only not be in accord with the Congressional intent, but with basic principles of utility regulation .

Under the traditional cost of service method of determining rates for regulated companies, it is settled that a return can be earned only on capital supplied by the investor. Thus, in *Washington Gas Light Co. v. Baker*, 88 U.S. App. D.C. 115, 188 F. 2d 11, 89 PUR NS 177 (1950), certiorari denied 340 U.S. 952, after stating that the Public Utilities Commission of the District of Columbia proceeded with the prudent investment theory of rate base in that case, it is said, p. 186 of 89 PUR NS:

“ * * * Primary emphasis is now being placed not on ‘specific property, tangible and intangible,’ but on capital prudently invested and embarked on an enterprise in the public service. * * * ”

Cited in support of the sentence above quoted is the concurring opinion by Mr. Justice Brandeis in *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Comm.*, 262 U.S. 276, 290. This opinion, stated to be the great classic in defense of the prudent investment principle of rate making (Bonbright, *Principles of Public Utility Rates* (1961), p. 184 n. 15), states the basis of that principle in the following language (262 U.S. 276, 290):

“ * * * The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return. Thus, it sets the limit to the power of the state to regulate rates. * * * ”

Since the investor is under this theory entitled only to a return on capital invested *by him*, it must follow that he cannot be entitled to earn a return on capital *not* supplied by him. This is confirmed by the cases.

Thus, in *Milwaukee & Suburban Transport Corp. v. Public Service Comm.*, 13 Wis. 2d 384, 108 N.W. 2d 729, the action of the Wisconsin Commission in deducting from rate base about \$980,000 representing the average of accruals for vacation pay and federal income tax was sustained, since it was found that these accruals represented capital supplied by users of the service on which the com-

pany was not entitled to earn a return. The Court said, page 394:

"* * * The accruals in question represent customer contributions not entitled to earn a return. They are not capital supplied by the stockholders, and to permit them to be included in the rate base would give the stockholders a return on money they did not invest.
* * *"

For other cases holding that a regulated company is not entitled to earn a return on capital not contributed by investors, see *Fox Point v. Public Service Comm.*, 242 Wis. 97, 7 N.W. 2d 571; *St. Francis v. Public Service Comm.*, 270 Wis. 91, 70 N.W. 2d 221; *Hagerstown v. Maryland P.S.C.*, 217 Md. 101, 141 A.2d 699, 24 PUR 3d 295. This rule applies even though it appears the regulated company has title to the capital so furnished. *Milwaukee & Suburban Transport Corp. v. Public Service Comm.*, *supra*; *Hagerstown v. Maryland P.S.C.*, *supra*.

The FPC has consistently deducted the average accruals for federal income taxes in computing the rate base, usually as an offset to working capital. *Transcontinental Gas Pipe Line Corp.*, 14 FPC 94, 100-4, 112, and cases cited herein; *Panhandle Eastern Pipe Line Co.*, 14 FPC 438, 463.

There is also direct authority respecting the proper treatment of an accrual for so-called deferred taxes from use of Section 167. The entire subject is discussed by James C. Bonbright in *Principles of Public Utility Rates* (1961). There Dr. Bonbright points out (pp. 219-22) the various possibilities, one of which ("the second alterna-

tive") is to permit an allowance for both accounting and rate making purposes for "normalizing taxes" with no offsetting deduction in determining rate base. In evaluating the various possibilities the author states, page 220:

"The second alternative is the one most popular with the public utility industries since, from their point of view, it has the charm of imposing upon the consumer the obligation to pay deferred-tax allowances which, instead of being transmitted forthwith to the United States Treasury, are to be treated as capital investments entitled indefinitely to the enjoyment of a 'fair rate of return' for the benefit of the corporate stockholders. * * * Support for this position of the industry has been forthcoming from the Federal Power Commission and from a few state commissions. *But I have never seen a plausible defense of this claim to the enjoyment of a profit on funds not contributed by the corporate investors.* The defense usually offered is that plant expansion financed by these funds enhances management costs and increases the risk factor. But management costs are covered in the allowances for operating expenses, not in the rate of return. And the risk factor (which may even be reduced, not increased, if the company is permitted to accrue a so-called deferred-tax reserve, as it will under Alternative Number 3) is properly taken into account in the allowance of a fair rate of return on capital contributed by the investors. Hence, there is no need to concede to stockholders a return on capital contributed, in effect, either by the taxpayers or by the consumers.

"As I see it, the only reasonable controversy as to the choice among the three above-noted alternatives is that between the view that, for rate-making purposes, companies should receive no allowances for taxes other than for actual current taxes, and the view that, if they practice liberalized-depreciation accounting for purposes of

income taxation, they should receive an annual allowance for deferred taxes combined with a deduction of the resulting deferred-tax reserve from what would otherwise be the rate base. Here I am convinced that the weight of the argument lies with the latter position, . . . (Emphasis ours)

This problem was recently before the Supreme Court of Illinois in *City of Alton v. Illinois Commerce Comm.*, 19 Ill. 2d 76, 165 N.E. 2d 513, 33 PUR 3d 76 (1960). The opinion of that court, written by Schaefer, J., contains an excellent discussion of the questions presented where a public utility elects to take liberalized depreciation for tax purposes as provided by Section 167 of the Internal Revenue Code. The Illinois Commission allowed the utility to claim for federal income tax expense, the amount of such taxes actually paid by using liberalized depreciation plus an additional amount representing what it would have paid had it used straight line depreciation, which amount as accrued each year should be credited to a special account which could be used for plant expansion but not for dividends or transfer to surplus. The trial court held this was erroneous and that only taxes actually paid should be allowed.

The Supreme Court of Illinois discussed the intent of Congress in adopting Section 167 and its impact upon regulated companies. It further discussed the question whether use of liberalized depreciation resulted in a tax saving or a tax deferral. The Court said that if it could say with certainty that continuing plant expansion was certain and countervailing considerations non-existent, it would hold that the Illinois Commission may not permit current charges for liabilities that will never arise. The Court then

commented, in substance, on the uncertainty of the future and the newness of the problem and other factors, and continued, page 86-7 of 33 PUR 3d:

"* * * At this time, we think it permissible for the commission to safeguard the financial integrity of utilities by recognizing as present expenses those tax liabilities which are deferred by use of accelerated depreciation for federal tax purposes.

"The commission may not, however, shift the benefit of accelerated depreciation from the ratepayers to utility shareholders. The commission's order states that prepayment of deferred taxes by present ratepayers will not benefit the company's shareholders because the funds so collected by the company may not be distributed as dividends or transferred to surplus. The order does not provide, however, that the prepaid funds must be deducted from the company's rate base. If this deduction is not made, the entire benefit of accelerated depreciation goes to the shareholders, since earnings produced by the prepaid funds—either interest if the funds are invested in securities or income if the funds are put into new plant facilities—will belong to the shareholders, who would thus receive a return on money they did not invest in the company.

"The commission's order therefore cannot stand. Funds generated by accruing deferred tax expenses, and any facilities financed out of those funds, must be excluded from the rate base. * * *"

For case holding it was not error in a rate case for a regulatory commission to deduct an amount represented by an account "Deferred Income Tax Availability" arising from use of accelerated amortization under Section 168 from working capital in determining rate base, which had

the effect of depriving the utility of a return on such capital, see *Public Service Company of New Hampshire v. State*, 102 N.H. 150, 153 A. 2d 801, 805 (1959).

4. *The Wisconsin Method.*

To answer any question which may arise in the mind of the reader as to the method followed by the Public Service Commission of Wisconsin in handling the problems arising from election of a regulated company to use liberalized depreciation under § 167, we submit a brief description of the method adopted by that Commission.

The method followed by the Wisconsin Commission where a regulated company elects to use liberalized depreciation under § 167 is to allow additional depreciation expense (over and above that under normal straight line depreciation) equal to the reduction in federal income taxes caused by use of liberalized depreciation. This increases the depreciation reserve by the annual amount of such additional depreciation over that which it otherwise would be. For rate making purposes the entire reserve is deducted in computing rate base. For rate making federal income tax expense is allowed on basis of the actual liability therefor, which is in accord with the leading case of *Galveston Electric Co. v. Galveston*, 258 U.S. 383. The accounting procedures adopted are consistent with the foregoing.

Wisconsin has had one case arising under § 124A, now § 168. The method followed was the same as in cases arising under § 167.

Under the Wisconsin method there are no deferred taxes either in expense or accumulated in a reserve. The matter is simply one of the allowance of a reasonable depreciation expense accompanied by deduction of the concomitant depreciation reserve. The latter, of course, means that the regulated company enjoys no return on the capital made available through use of the methods provided in §§ 167 and 168. The Wisconsin method is supported by a letter by Dr. James L. Dohr, late Professor of Accounting at Columbia University, in *The Journal of Accountancy* (February 1959 issue), where it is said, *inter alia* (pp. 19-20):

“• • • Without going into the details, it appears that someone has concocted, and many have accepted, the idea that there has been a deferral of tax liability. The Revenue Act may in a sense result in a deferral of tax, but there is obviously no deferral of tax liability—there is no tax liability to defer. The statute levies no future tax, and upon payment of the tax for the current year there is, at the end of the year, no further tax liability of any kind or description. What will happen in the future depends upon Congressional action as to rates, deduction, etc., continued existence, continued profitability, etc. And to go further and spin out an ‘interest-free loan from the government’ is a morbid action again wholly beyond the facts. There is no ‘loan,’ governmental, interest-free, or otherwise. Strangely enough, people who cite the Congressional reports to support their theories are almost always prone to overlook the fact that Congress indicated it was authorizing what it believed was a better method of computing depreciation. The idea of setting up a tax liability is wholly unjustified, and we should stop using that approach and that terminology in all areas, including the public utilities.

"Another concoction which many have accepted is the idea that the charge should result in an 'appropriation of retained earnings.' The message to the stockholder is 'this is your money now, but you will in all probability have to pay it over to the government in the approaching years.' This idea is not as bad as that of the deferred liability, but it is still some distance from the facts, and I understand that the SEC is on the verge of outlawing it.

"The simple and understandable solution is to credit accrued depreciation. The taking of a deduction in the tax return decreased the 'tax liability' of the asset and the amount carried forward (i.e., the asset) should reflect this partial utilization and recovery of the cost through reduced taxes; in the absence of this reduction the asset is simply overstated.

"The corporation which deducts liberalized depreciation in its tax return but not on its books should (a) charge as depreciation in its income statement an amount equal to the tax reduction and (b) credit accrued depreciation to reflect the utilization of tax deductibility.

"Simple, straightforward, factual and understandable."
(Underlining indicates italics in original.)

Respectfully submitted,

WILLIAM E. TORKELSON

Chief Counsel, Public Service
Commission of Wisconsin

Attorney for Public Service
Commission of Wisconsin, *amicus curiae*

December 1962.

One West Wilson Street
Madison, Wisconsin

ANSWER OF PANHANDLE EASTERN PIPE LINE
COMPANY TO BRIEFS OF STATE COMMISSIONS
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IN THE
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On Petition to Review an Order of the Federal Power
Commission

HARRY S. LITTMAN
DALE A. WRIGHT
RICHARD LITTELL
MELVIN RICHTER

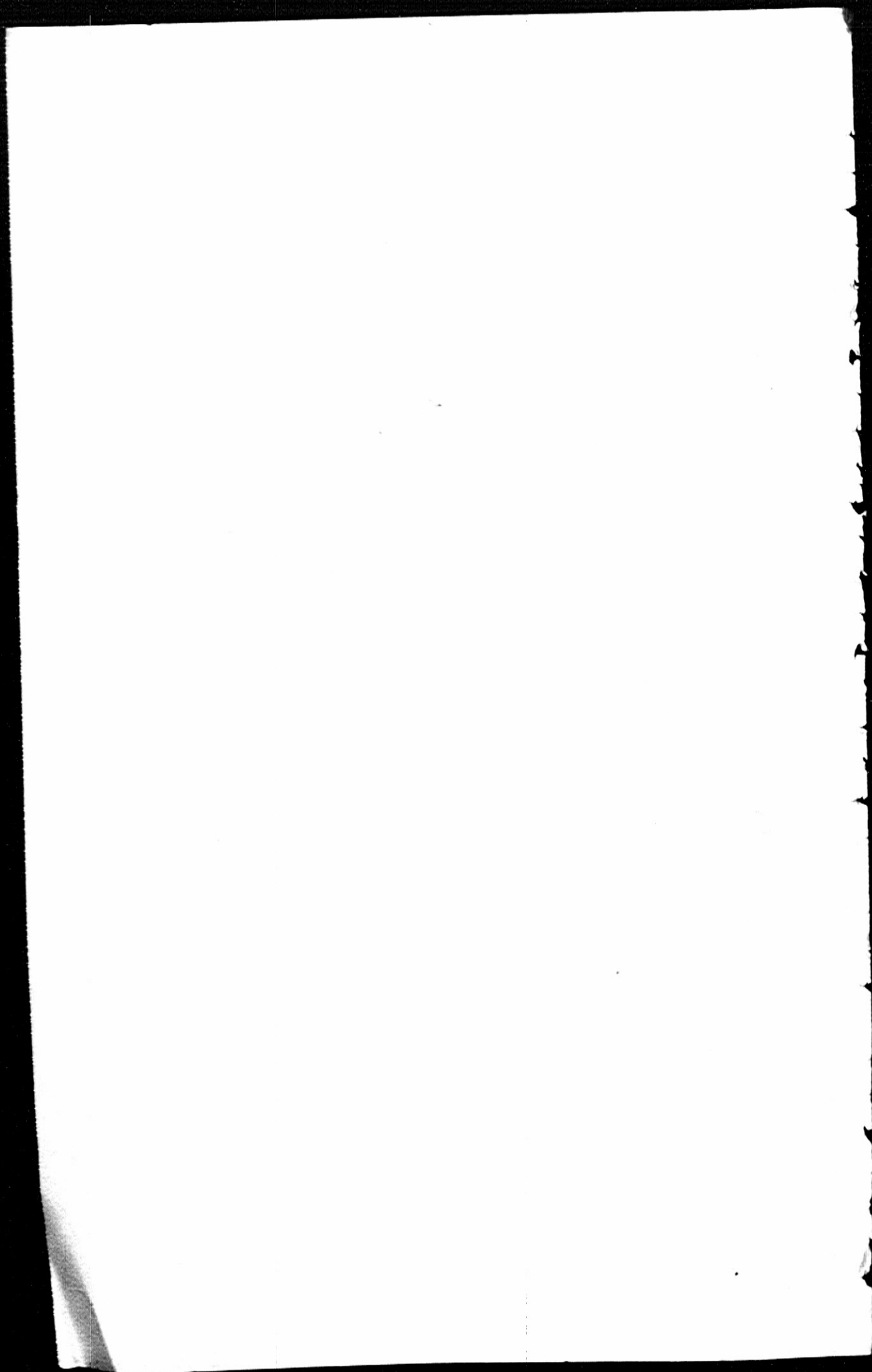
United States Court of Appeals 317 Wyatt Building
for the District of Columbia Circuit Washington 5, D. C.

JOSEPH J. DANIELS
BAKER & DANIELS
810 Fletcher Trust Building
Indianapolis 4, Indiana

ROBERT P. PATTERSON, JR.
PATTERSON, BELKNAP & WEBB
1 Wall Street
New York 5, New York

Attorneys for
Panhandle Eastern Pipe Line Company

December 24, 1962



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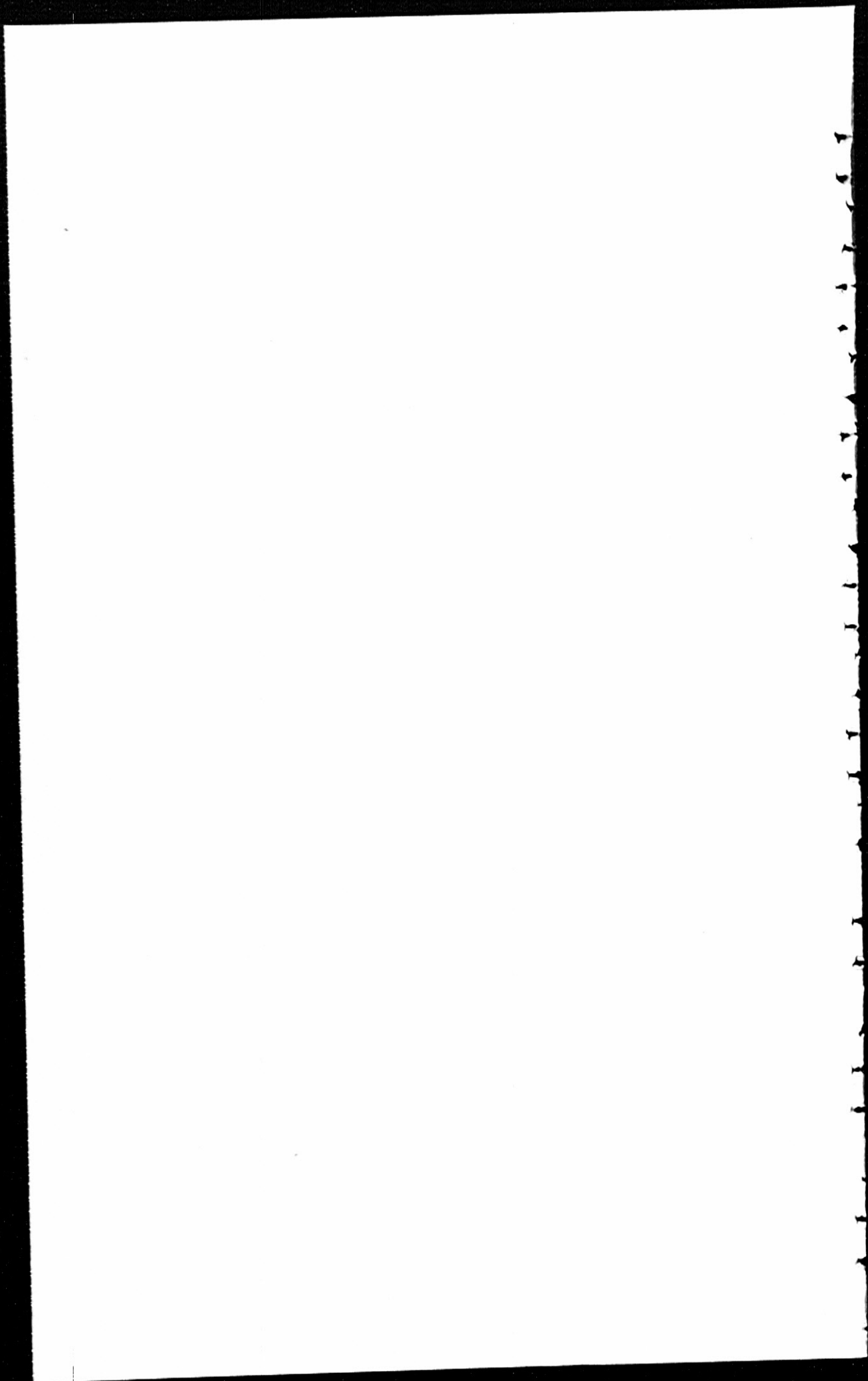
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**ANSWER OF PANHANDLE EASTERN PIPE LINE
COMPANY TO BRIEFS OF STATE COMMISSIONS
AS AMICI CURIAE**

**On Petition to Review an Order of the Federal Power
Commission**

I

SECTIONS 166 AND 167 SHOULD BE TREATED ALIKE

The Wisconsin Public Service Commission (Br., pp. 4-5) and the California Public Utilities Commission (Br., p. 3) contend that *City of Detroit* is not controlling for that portion of Panhandle's deferred tax reserves which were accrued under Section 167 of the Internal Revenue Code. *City of Detroit v. F.P.C.*, 97 App. D.C. 260, 230 F. 2d 810

(1955), *cert. denied* 352 U.S. 829 (1956). Pointing out that *City of Detroit* dealt with Section 168 of the Code, these amici assert that Sections 167 and 168 should be treated differently. We will show, however, that this contention is in error.

A. Sections 167 and 168 Have Similar Legislative Purposes

There is no merit to the Wisconsin PSC's assertion (Br., p. 5) that Sections 167 and 168 have "different legislative . . . purposes." As respondent FPC conceded (Orig. Br., p. 16), the two provisions alike "were intended generally to foster industrial growth and expansion" Indeed, the Wisconsin Commission's own characterization of legislative purpose (Br., pp. 12, 15-18) acknowledges that this is so.

These concessions are fully supported by the legislative history, which is set forth in detail in Appendix "A" hereto. As there shown, Section 168 was designed to encourage the use of private capital in the construction of defense facilities. Section 167 was likewise enacted to promote plant expansion. As the committee reports stated regarding the latter provision:

" . . . For *all* segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living." H. Rept. No. 1337 (p. 24) and S. Rept. No. 1622 (p. 26), 83d Cong., 2d Sess. (1954).¹

Similarly, as the FPC conceded (Orig. Br., p. 12), Congress intended both Sections 167 and 168 to benefit all taxpayers participating thereunder, including regulated utilities. This was emphasized in the explanation of Senator

¹ Except where otherwise indicated, emphasis is supplied throughout this brief.

Millikin, Chairman of the Senate Finance Committee, regarding Section 167:

"The bill, as it passed the House, applies to *all* types of tangible depreciable assets, including farm equipment, machinery and buildings, rental housing, and industrial and commercial buildings, as well as machinery and equipment. . . .

.

"The new method for depreciation will be available to *all* taxpayers with depreciable property. . . . (100 Cong. Rec. 8997, 8998 (1954)).

Congress' failure to except regulated utilities from the ambit of Section 167 was clearly deliberate. During the hearings, representatives of electric, gas and telephone utilities had emphasized how utilities found the previously used straight-line method of depreciation unfair to them particularly in view of the declining value of the dollar. Hearings on General Revenue Revision before the House Committee on Ways and Means, 83d Cong., 1st Sess., e.g., pp. 705-9, 725-30, 734-39 (1953). And in view of its aim to stimulate the economy, Congress could not have overlooked the effect if regulated industries, which are among the nation's largest investors in plant, were denied the benefits of Section 167.

Even more pertinently, when the Senate Finance Committee had under consideration the 1954 Internal Revenue Code, the FPC on May 7, 1954 called the Committee's attention to the fact that Section 167 (and Section 168) would be applicable to public utilities. See *Rapid Amortization in Regulated Industries*, S. Rept. No. 1380, 85th Cong., 2d Sess. 82 (1958).

The legislative history thus demonstrates that Sections 167 and 168 were enacted with similar objectives (See also Slip Op., p. 5). Indeed, Section 167's most outspoken opponent, Senator Morse, recognized during debate on the legislation which first authorized liberalized depreciation:

"* * * [W]hat it does, in effect, is to carry over into peacetime operations the principle of the certificate of necessity for accelerated amortization of depreciation during a war period and a defense emergency period" (100 Cong. Rec. 12538 (1954)).

B. Both Sections 167 and 168 Result in Tax Deferrals. Not Tax Savings

Echoing a position suggested by respondent FPC for the first time on rehearing (Pet., pp. 8-11), the amicus State Commissions contend that Sections 167 and 168 have different effects. All three parties concede that Section 168 results in a tax deferral. But for Section 167 it is contended that "In the case of utility plant with numerous units of property where the property continues to grow or even remains static, * * * a tax saving results" (Wisc. PSC's Br., p. 8. See Calif. PUC's Br., p. 4).

But this contention is contrary to Congress' understanding that liberalized depreciation under Section 167 would provide only a tax deferral. In proposing legislation authorizing liberalized depreciation, the President of the United States said:

"Faster depreciation, it should be noted, will merely shift the tax deductions from later to earlier years. It will not increase total deductions. The change should, in fact, increase Government revenues over the years because of the stimulation which it will give to enterprise and expansion." 100 Cong. Rec. 571. See also the President's Budget Message, 1 U.S. Code Cong. & Ad. News 1557, 1566-67 (1954).

Congress also understood that liberalized depreciation resulted only in a shift in timing of payment of taxes, not in a permanent tax reduction. The House Ways and Means Committee Report accompanying the 1954 Code revision bill, of which the liberalized depreciation provision was a part, identified the various diverse measures in the overall bill as "Items Having Direct Revenue Effect" and

"Items Which Merely Shift Deductions or Income Between Taxable Years" (H. Rept. No. 1337, *supra*, p. 3). Liberalized depreciation was classified as a deduction shifting device (*Ibid.*). The Committee Report explained this as follows:

"The changes made by your committee's bill merely affect the timing and not the ultimate amount of depreciation deductions with respect to a property" (*Id.* at 25).

Congress reached this conclusion after being advised of the very argument advanced here by the amicus State Commissions. See Hearings on the Internal Revenue Code of 1954 Before the Senate Committee on Finance, 83d Cong., 2d Sess. 679-80 (1954).

Furthermore, the contention that Section 167 will produce tax savings is based upon the patently unrealistic assumption that a natural-gas pipeline company's plant additions will equal or exceed retirements for the indeterminate future. This assumption ignores the fact that the natural-gas pipeline industry has a life which is limited by the wasting asset character of its gas reserves and, consequently, cannot continue to expand indefinitely. *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 606 (1944).

In recognition of these very facts, counsel for the FPC recently advised the Supreme Court in its brief dated April, 1961 in opposition to certiorari in the *El Paso* case, *California v. F.P.C.* (Oct. Term, 1960, No. 599, pp. 14-15):

"* * * Petitioners' assumptions of a continual plant growth and a continuously expanding investment in depreciable property, i.e., plant additions exceeding retirements, are at best largely speculative and conjectural. It was within the Commission's discretion to decline to make these assumptions. On the other hand, it is known, and petitioners must concede, that, as the tax law now stands, higher deductions and lower taxes prevail only during the early depreciable life

of a property unit, whereas lower deductions will prevail during its later life. *Petitioners therefore do not, and cannot, show that the ultimate net results will be an outright tax saving. . . .*

In addition, the amicus State Commissions' position is unsupportable because it assumes that statutory authorization of liberalized depreciation will continue indefinitely. To be sure, the FPC stated in its Petition for Rehearing (p. 10), and again in oral argument before the Court *en banc*, that Section 167 is written "as a permanent part of our tax law" But this proves nothing since the analogous provisions of Section 168, which also were written "as a permanent part of our tax law," have now been made unavailable to civilian industries (71 Stat. 414). And bills to repeal the depreciation provisions have been introduced frequently (e.g., in the First Session of the Eighty-Fifth Congress alone: H.R. 127, H.R. 4806, H.R. 8120).

Moreover, the amicus State Commissions apparently assume that Panhandle's capacity to expand and acquire new property will never be limited by competition from other fuels and from other sources of energy, general economic declines, or shortages due to war or other national emergency. Yet any one or combination of these factors could effectively stop any expansion by the natural gas companies. The recent behavior of the stock market and the even more recent Cuban crisis show how naive it is to assume a continually expanding economy.

To cope with these obvious possibilities, the California Commission contends that "if and when the tax bill increases the company will be allowed to adjust its rates accordingly" (Br., p. 5). Whether Panhandle would be able to collect such higher rates in the future, however, is wholly speculative. Surely Panhandle could not do so if the deferred taxes came due after the contraction of its gas reserves. Nor could it do so if the ever-increasing

rivalry from other fuels threatened to price Panhandle's gas out of highly competitive markets. In any event, if utilities were required to share with their ratepayers the temporary reduction of income taxes in the early years and pass on the increased taxes in later years: "This would defeat the purpose of the Commission's present order." (See Slip Op., p. 9).

It is thus clear that Section 167 does not, and cannot, produce a permanent tax saving for Panhandle and the other natural-gas companies. It is inevitable that the gas supply will be reduced or that the tax laws will be amended or that for other reasons Panhandle will decrease the amounts of tax depreciation in future years. When that unavoidable time comes, Panhandle will have to pay the taxes that have been deferred. The deferred taxes accumulated in a restricted reserve have been earmarked for such purpose and under the Commission's System of Accounts cannot be used to pay dividends. (Sections 281 and 282 of Uniform System of Accounts under the Natural Gas Act, 18 C.F.R., 201.281 and 201.282).

C. The Position of the Amicus State Commissions Is Contrary To All FPC Decisions, Including the Order Under Review

In arguing that Section 167 produces a tax saving and that it should be treated differently from Section 168, the amicus State Commissions take a position which is contrary to both the instant order and all FPC precedent.

In the order under review the FPC treated Panhandle's tax accruals not as tax savings, but as "deferred taxes" (R. 3551). This was in conformity with Opinion No. 342, on which the instant order was based. There the Commission said that "the statute allowing liberalized depreciation [Section 167] * * * defers to the later life of a given property a portion of the taxes on income that would be payable in the early years under straight-line deprecia-

tion, and gives the company the use of such moneys in the interval" (FPC's Orig. Br., App., p. 41).

The FPC thus followed in the instant order an unbroken series of Commission decisions holding that Section 167, like Section 168, results in a tax deferral, not a tax saving. Thus, in *Amere Gas Utilities Co.*, 15 F.P.C. 781, 782 (1956),² the Commission found that Section 167 "operates to create a deferral of income taxes * * *." More recently, in *El Paso Natural Gas Co.*, 22 F.P.C. 260, 267 (1959), the Commission held that under Section 167 "There is thus a deferral of taxes * * *." And in *United Fuel Gas Co.*, 23 F.P.C. 127, 130 (1960),³ the Commission noted that Congress intended the taxpayers to retain "the tax deferrals arising from liberalized depreciation * * *." In affirming the FPC's treatment of liberalized depreciation, the Fifth Circuit concluded that Section 167 "works a tax deferral rather than a tax savings." *El Paso Natural Gas Co. v. F.P.C.*, 281 F. 2d 567, 573 (1960), *cert. denied sub nom. California v. F.P.C.*, 366 U.S. 912 (1961).

Furthermore, the FPC has specifically rejected the argument that it could assume that natural-gas pipelines would continue to expand and achieve tax savings. In its *Amere* decision, the FPC considered voluminous evidence offered by the Wisconsin PSC, among others, which was claimed to show that for a growing or static plant, the deferred taxes would never become due (15 F.P.C. at 772). The Commission stated (15 F.P.C. at 782):

"The fact that there may be continuing additions to plant, year by year, with the result that there will be a balance in the reserve account at all times in the foreseeable future, does not prove that there is no tax deferral. On the contrary, it proves that there

² *Appeal dismissed sub nom. Cities of Lexington, etc., Ky. v. F.P.C.*, C.A.D.C. No. 12590 (June 26, 1957).

³ *Aff'd in part sub nom. Cities of Lexington, etc., Ky. v. F.P.C.*, 295 F. 2d 109 (4th Cir. 1961).

is a continuing tax deferral so long as additional facilities are being installed. This is precisely what Congress intended."

Equally novel is the amicus State Commissions' assertion that Sections 167 and 168 should be treated differently. In the order under review the FPC treated these two provisions alike, denying to Panhandle the major part of the benefits of both. In Opinion No. 342, adopted by the Order here under review, the FPC refused to distinguish between the two statutory provisions (FPC's Orig. Br., App., p. 47):

"* * * We believe it wiser not to attempt to distinguish between these two statutes but to adopt the same view as to all tax accruals, whether obtained from use of Section 167, dealing with liberalized depreciation, or Section 168, dealing with accelerated amortization." See also *Kansas-Nebraska Natural Gas Co.*, 25 F.P.C. 448, 451 (1961).

Similarly, in its *Amere* Opinion, dealing with Section 167, the FPC stated that it could "find no legal difference between the problem" presented by Section 167 "and that which was presented * * * by section 124A (now section 168) of the Internal Revenue Code * * *" (15 F.P.C. at 781-82). It thus affirmed the decision of the presiding examiner, who had found: "* * * [N]o significant distinction can be seen between the congressional objective with respect to section 167 and the congressional purpose with respect to section 168" (15 F.P.C. at 779).

Obviously, it is improper to attempt to support the FPC's order by supplying different grounds from those on which the order was based. The FPC's findings in the instant order that Section 167 produces a tax deferral and should be treated the same as Section 168 were not challenged. Under Section 19 of the Natural Gas Act (15 U.S.C. 717r), such findings are final and not subject to review. As this Court recently held:

"Ordinarily 'the grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based,' *Securities & Exchange Comm'n v. Chenery Corp.*, 318 U.S. 80, 87, 63 S. Ct. 454, 459, 87 L. Ed. 626 (1943). We could sustain the Board's order upon a ground which it did not consider only if that ground were 'one within the power of . . . appellate court to formulate.'" *Local 833, U.A.W. v. N.L.R.B.*, _____ App. D.C. _____, 300 F. 2d 699, 705 (D.C. Cir. 1962), *cert. denied* 370 U.S. 911 (1962). See also *Sunray Mid Continent Oil Co. v. FPC*, 353 U.S. 944 (1957); *Texas Gas Transmission Corp. v. Shell Oil Co.*, 363 U.S. 263, 270 (1960).

A fortiori, this Court cannot sustain the FPC's decision upon grounds which the record discloses are squarely opposed to those upon which the FPC's action was based. Indeed, on a rehearing the court does not even have to consider arguments that were not presented before.* *General Accident Fire & Life Assurance Corp. v. Smith and Oby Co.*, 274 F. 2d 819 (6th Cir. 1960); *W. E. Hedger Transportation Corp. v. Ira S. Bushey & Sons*, 155 F. 2d 321, 325 (2d Cir. 1946) *cert. denied*, 329 U.S. 735; *Minute Maid Corp. v. United Foods, Inc.*, 291 F. 2d 577, 585-86 (5th Cir. 1961), *cert. denied* 368 U.S. 928.

II

CONGRESS CLEARLY INTENDED THAT SECTIONS 167 AND 168 SHOULD BENEFIT THE TAXPAYER, NOT THE CONSUMER

Like respondent FPC (Pet., pp. 11-13), the amicus State Commissions dispute the majority's conclusion that "Congress has not provided that, with respect to utilities, ratepayers are entitled to share in the temporary benefits resulting from the use of liberalized depreciation in computing income taxes" (Slip Op., p. 9). The Wisconsin PSC asserts (Br., pp. 11-19) that the Court erred regarding

*As we pointed out during oral argument, the FPC did not argue in its brief to the original panel herein that Section 167 works a tax saving, rather than a deferral.

both Section 167 and Section 168, while the California PUC quarrels (Br., pp. 6-11) only with the Court's holding as to Section 167.

There is no substance to the contention that Congress intended Section 167 (or Section 168) to produce "lower rates to consumers * * *" (See Wisc. PSC's Br., p. 12. See also Calif. PUC's Br., pp. 9-10). We have already shown that Congress' sole purpose in enacting these tax benefits was to encourage all taxpayers, including regulated utilities, to make increased investments in plant and equipment. The legislative history also demonstrates that Congress intended these new facilities to be financed by the additional working capital and temporary tax reductions produced by liberalized depreciation. It was thus Congress' understanding that the tax deferrals would be retained by the taxpayer, rather than passed on to the consumer in the form of price reductions. For example, both committee reports emphasized that:

"* * * The faster tax write-off would increase available working capital and materially aid growing businesses in the financing of their expansion." H. Rept. No. 1337 (p. 24) and S. Rept. No. 1622 (p. 26), 83d Cong., 2d Sess. (1954).

Referring in debate to Section 167, the Chairman of the House Ways and Means Committee explained (100 Cong. Rec. 3424 (1954)):

"* * * By allowing businesses to recover a large part of their costs more quickly, it will be of particular assistance to growing businesses in financing their expansion."

See also 100 Cong. Rec. 3434, 3553 (Statements of Representatives Byrnes and Knox, quoted in Appendix hereto).

Equally without support in the legislative history is the contention that "The Congressional intent * * * does not warrant the conclusion that the regulated company is en-

titled to a return on the * * * reserve for deferred taxes" (Wise. PSC's Br., pp. 14, 11. See Calif. PUC's Br., p. 6). Like respondent FPC the amicus State Commissions take a position which is contrary to the legislative history discussed above. Their position is also diametrically opposed to the reading of the legislative intent by both this Court and by the FPC which has been approved by Congress.

The FPC has uniformly held that it was the intent of Congress to allow regulated taxpayers to retain the full benefits of Sections 167 and 168. It first reached its conclusion in declaratory and rule-making proceedings devoted to a full analysis of the legislative history. *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 F.P.C. 369 (1953) (Section 168); *Amere Gas Utilities Co., supra* (Section 167). Subsequently, the FPC implemented its conclusion in setting rates. *E.g. Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53, 81-84 (1954); *El Paso Natural Gas Co., supra*, 22 F.P.C. at 266 ("[T]he intent of Congress was *not* to benefit consumers * * *"); *Phillips Petroleum Co.*, 24 F.P.C. 537, 570 (1960)⁵ ("The accelerated amortization provisions were to benefit the taxpayer, *not* the consumers").

In each of these and other rate proceedings prior to Opinion No. 342, the FPC construed the congressional intent to mean that the natural-gas company "is entitled to a return on the * * * reserve for deferred taxes." The FPC did so in the traditional manner by determining the company's rate of return on the basis of the cost of its actual capitalization, without including deferred tax accruals. Indeed, it rejected proposals which, like the instant order, would artificially treat accrued taxes as though they were a part of capitalization (See 24 F.P.C. at 570). The FPC thus fixed rates which enabled the company to

⁵ *Aff'd sub nom. State of Wisconsin v. F.P.C.*, App. D.C., 303 F.2d 380 (1961), cert. granted sub nom. *State of California v. F.P.C.*, 82 S.Ct. 1138 (1962).

earn the same full fair rate of return on the facilities financed by the deferred tax funds as on the facilities financed by conventional sources of capital.

This, of course, is precisely the treatment of deferred taxes which this Court approved in *City of Detroit*. There this Court held that it was "*the intent of Congress*" in enacting Section 168 (formerly Sec. 124A) "not to benefit consumers but rather the taxpayer;" and that "*the Congressional intent is effectuated*" when the accrued tax fund is made available to Panhandle for investment in property on which "*it is entitled to earn a fair rate of return*" (230 F. 2d at 822). In *El Paso Natural Gas Co. v. F.P.C.*, *supra*, the Fifth Circuit similarly approved the FPC's treatment of Section 167 (281 F. 2d at 573-574).

As described at greater length in the attached summary of the legislative history (Appendix "A" hereto), Congress has been advised frequently of this Court's and the FPC's interpretation of legislative intent. In its Annual Reports for 1954 (pp. 118-119) and 1956 (p. 12), the FPC told Congress how it and this Court in *City of Detroit* had treated Section 124A (now Section 168) in Panhandle's rate case. And in its Annual Reports for 1956 (pp. 75-76) and for 1957 (p. 75), the FPC told about its decision regarding Section 167.

The FPC also specifically informed Congress about its 1956 *Amere* decision that Section 167 was intended to benefit taxpayers, not consumers. As noted in the *Amere* Opinion itself (15 F.P.C. at 782), the FPC did so by transmitting copies of the Opinion to the Senate Finance Committee and the House Ways and Means Committee.

Subsequently, in 1957, two bills were introduced in the Congress to amend the Federal Power Act to exclude the tax benefits of Sections 167 and 168 in fixing rates. H.R. 5824 and S. 2113, 85th Cong., 1st Sess. (1957). These bills failed of passage.

Finally, the FPC's treatment of both Sections 167 and 168 was exhaustively explored in an investigation by the Senate Antitrust and Monopoly Subcommittee of the Committee on the Judiciary. During a colloquy between Mr. Paul Rand Dixon, then Subcommittee Counsel, and Mr. Willard W. Gatchell, then FPC General Counsel, the Subcommittee specifically focused upon the *City of Detroit* decision:

"Mr. Dixon. . . . It is true, isn't it, that under the holdings of the Federal Power Commission, for instance, in the Panhandle case that has been called to my attention—

"Senator Kefauver. What is the order number and the case number?

"Mr. Gatchell. It is docket No. G-1116, opinion No. 269, and it is commented upon by the court of appeals in the case cited as *City of Detroit v. Federal Power Commission*, sir. Certiorari was denied, so we do not have a Supreme Court opinion. But the court of appeals decision is in 230 Federal 2d, 810; certiorari denied (352 U.S. 829, 919).

• • • • •
 "Mr. Dixon. It was held in that case, wasn't it, that the consumer was not meant to benefit from tax amortization? That is true, isn't it?

"Mr. Gatchell. Yes, sir.

"Senator Wiley. What was that, now?

"Mr. Dixon. That the consumer was not meant to benefit by tax amortization.

"Senator Wiley. The public was not to gain?

"Mr. Dixon. That was the holding of the Commission and was approved by the circuit courts, as Mr. Gatchell has pointed out." Hearings on Rapid Amortization in Regulated Industries Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 85th Cong., 1st Sess. 923 (1957).

The Subcommittee thereafter published in March 1958 its report on the investigation. S. Rept. No. 1380, 85th Cong., 2d Sess. It noted, among other things, that "under the regulations of the Federal Power Commission, as upheld by the courts, it has been held that Congress did not intend consumers to benefit through lower rates as a result of tax amortization but rather that the inducement was intended as a benefit to the * * * company" (p. 4. See also pp. 67-68). And it noted (p. 81) that the Subcommittee chairman had transmitted his findings "to the chairmen of the Senate Finance Committee and the House Ways and Means Committee * * *."

Congress has amended both Section 167 (72 Stat. 1665) and Section 168 (71 Stat. 414; 72 Stat. 1608). But it did not make any changes to correct any claimed misinterpretation of congressional intent either by the FPC or by this Court. In the past, the FPC has read Congress' action as "affirming [the FPC's] interpretation of its intentions." *El Paso Natural Gas Co.*, *supra*, 22 F.P.C. at 267. In *Panhandle Eastern Pipe Line Co. v. F.P.C.*, 232 F. 2d 467, 471 (3d Cir. 1956), *cert. denied*, 352 U.S. 891, the Court stated:

" * * * [W]here, with the Commission's position of record, Congress amended the Act, as it did, without changing that part of it so construed implied approval of that interpretation is strongly evidenced. *Helvering v. R. J. Reynolds Tobacco Co.*, 1939, 306 U.S. 110, 115, 59 S. Ct. 423, 83 L. Ed. 536; *United States v. Dakota-Montana Oil Co.*, 1933, 288 U.S. 459, 466, 53 S. Ct. 435, 77 L. Ed. 893" [footnote omitted].

As in the cases cited by the Third Circuit, the Supreme Court has repeatedly reached the same conclusion. E.g., *Cammarano v. U.S.*, 358 U.S. 498, 510 (1959); *Boehm v. Commissioner*, 326 U.S. 287, 291, 292 (1945); *Helvering v. Winmill*, 305 U.S. 79, 83 (1938); *Old Mission Portland Cement Co. v. Helvering*, 293 U.S. 289, 293-94 (1934).

III

THE OTHER CONTENTIONS OF THE AMICUS STATE COMMISSIONS ARE WITHOUT MERIT

The amicus State Commissions make a number of other contentions not connected with congressional intent. In our earlier responses to the brief and petition of respondent FPC, we have already answered most of these arguments. It will suffice, therefore, to make only the following brief comments concerning such contentions.

1. The California PUC contends (Br., p. 5) that *City of Detroit* did not involve "the question before the Court now; namely, what return must be allocated to the reserve accounts." This, of course, is the position of the Chief Judge in dissenting from the majority's decision here (Slip Op., p. 12). We respectfully disagree.

In *City of Detroit*, as shown above, the FPC had allowed Panhandle to earn the same full fair rate of return on the facilities financed by deferred tax funds as on all of its other property. Therefore, when this Court held that it would be wrong to deduct the tax accruals from the rate base because this would decrease "the valuations upon which it [Panhandle] is entitled to earn a fair rate of return . . ." (230 F. 2d at 822), the Court was referring to the full fair return which the FPC had actually allowed on the deferred taxes. Even the FPC recognized in Opinion No. 342 that it was "the apparent view of the court in the *City of Detroit* case that moneys in the deferred tax account were the company's money and that it was entitled to all income produced from such moneys . . ." (FPC's Br., App., p. 47).

Furthermore, the FPC's present formulation of the issue in terms of "rate of return" is nothing more than a deliberate attempt to do indirectly what it was forbidden to do directly in *City of Detroit*. This fact, which the majority recognized here (Slip Op., p. 8), is explained at pages 3-4

of our Answer to the FPC's Petition (See also our Reply Br., pp. 6-8; and Initial Br., pp. 19-20). We respectfully refer the Court's attention to our discussion on those pages, which we will not repeat here.

2. The amicus Commissions also rely on various State cases. In our Answer to the FPC's Petition (p. 7), however, we pointed out that there is a division among State commissions. In any event, the FPC has explained in its brief in opposition to certiorari (p. 15) in *California v. F.P.C.*, *supra*, one of the reasons why the State cases are inapplicable:

"The state commission cases have seldom, if ever, involved the natural gas pipeline industry. Continued expansion for the indefinite future can more readily be assumed for the electric power and telephone industries than for gas pipelines, which are dependent on the continuing discovery of exhaustible reserves." * * *

In the final analysis, those States which have not followed *City of Detroit* have ignored the Congressional intent. In this regard it is pertinent to note that the FPC stated at page 5 of its Petition for Rehearing that this Court's "present decision is probably not legally binding on State regulatory agencies * * *." But we are dealing here with the Federal Power Commission, an arm of the federal government, which is duty bound to respect the intent of Congress.

3. Both the California PUC (Br., pp. 6-9) and the Wisconsin PSC (Br., pp. 21-25) rely on various judicial decisions. In our Reply Brief (pp. 18-19) and our Answer to the FPC's Petition (pp. 6-7, n. 6), however, we explained that the cited portions of the *El Paso*, *Lexington* and *Panhandle** decisions did not refer to *tax deferrals* under Sec-

* *Panhandle Eastern Pipe Line Co. v. F.P.C.*,
F.2d 763 (1962), cert. *denied*, 31 L.W. 3206.

App. D.C. , 305

tions 167 and 168. Rather, they referred only to the *tax savings* resulting from the deductions from percentage depletion and intangible well-drilling and development costs allowed to producers of natural gas by Internal Revenue Code Sections 611-613 and 263(c), 26 U.S.C. §§ 611-613 and 263(c). As the Commission itself has recognized, for rate of return purposes it must treat tax deferrals differently from tax savings. *United Fuel Gas Co., supra* (23 F.P.C. at 513).

4. In our Reply Brief (p. 20), we pointed out the fallacy in the Wisconsin PSC's contention (Br., pp. 20-21) that the majority's decision would result in allowing Panhandle rates which are "in excess of a fair return." In our Answer to the FPC's Petition (pp. 16-17), we also demonstrated the error in the Wisconsin PSC's argument (Br., pp. 7-8) that Panhandle's tax accruals are "capital . . . provided by the rate payers."

At pages 24-26 of our Opening Brief, we showed why there is no foundation for the California PUC's belief (Br., p. 12) that "there is evidence to support the Commission's conclusion that its treatment provides incentive to invest in plant and equipment and . . . to elect to compute tax liability using the liberalized methods provided by Section 167." (See also our Reply Br., pp. 9-10). And we explained at pages 22-23 of our Initial Brief why both the California PUC (Br., pp. 5-6) and the Wisconsin PSC (p. 19) err in attacking this Court's statement in *City of Detroit* that its solution "does not result in higher rates to the consumer" (230 F. 2d at 822).

Finally, with regard to the California PUC's contention (discussed above) that *City of Detroit* is not controlling here because that decision dealt only with Section 168, we note that, as the Wisconsin PSC recognizes (Br., p. 5), the larger part of the deferred tax accruals here involved are attributable to Section 168. Of Panhandle's \$11,076,954 tax reserve, \$6,960,095 were accrued under Section 168. In-

deed, the instant proceeding involves the same accruals on facilities which were the subject of the *City of Detroit* case, as well as further accruals on these same facilities and similar accruals made on facilities which were built in reliance on the Court's holding. The Commission's order on review, therefore, could in no event be affirmed.

CONCLUSION

For the reasons stated above and in our Answer to Respondent FPC's Petition, we respectfully submit that the Court *en banc* should affirm the majority's decision herein of September 27, 1962.

Respectfully submitted,

PANHANDLE EASTERN PIPE
LINE COMPANY

By /s/ HARRY S. LITTMAN

Its Attorney

HARRY S. LITTMAN

DALE A. WRIGHT

RICHARD LITTELL

MELVIN RICHTER

317 Wyatt Building

Washington 5, D. C.

JOSEPH J. DANIELS

Baker & Daniels

810 Fletcher Trust Building

Indianapolis 4, Indiana

ROBERT P. PATTERSON, JR.

Patterson, Belknap & Webb

1 Wall Street

New York 5, New York

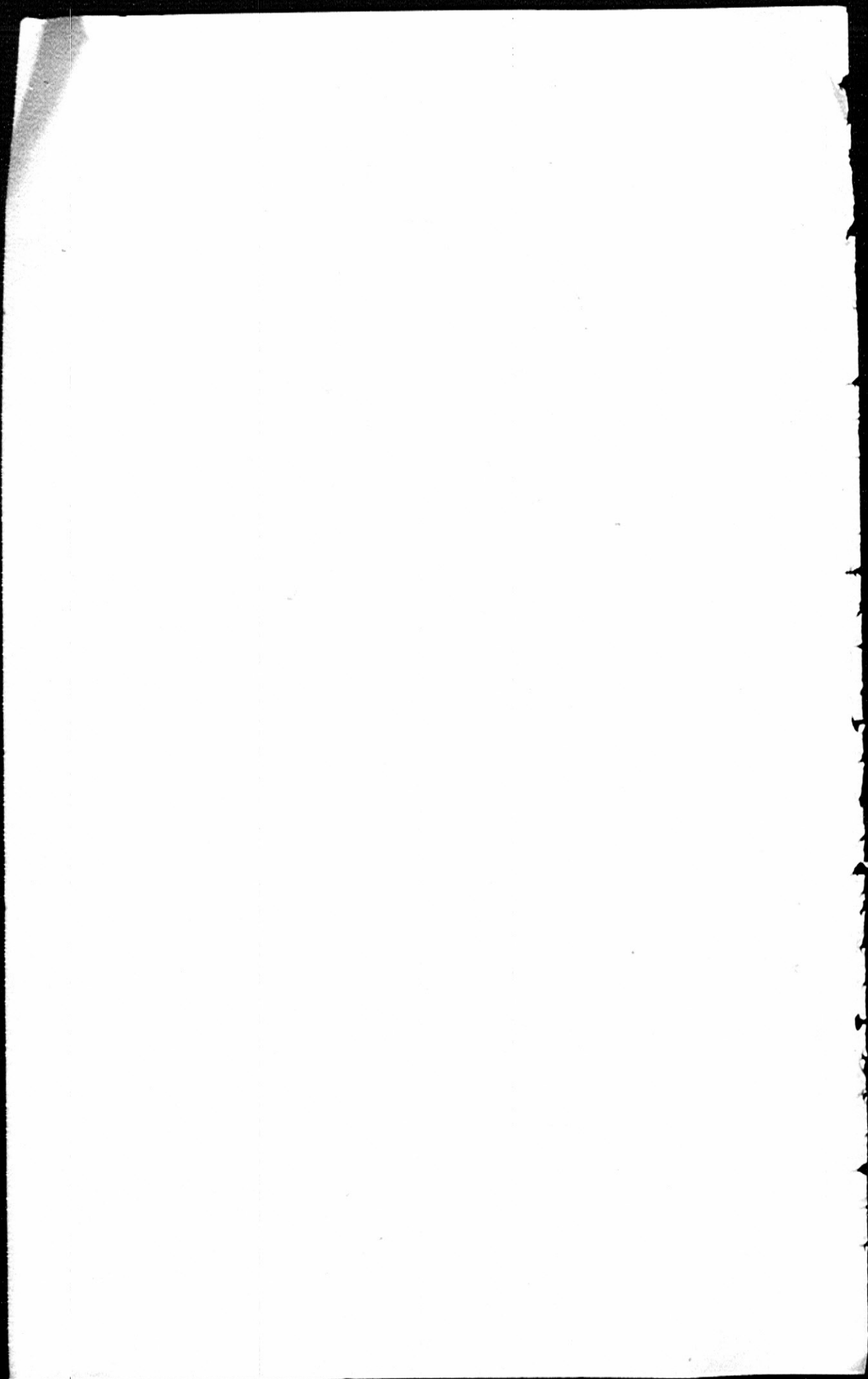
Attorneys for Panhandle Eastern

Pipe Line Company

December 24, 1962

APPENDIX A

LEGISLATIVE HISTORY OF SECTION 167 AND SECTION 168 OF THE INTERNAL REVENUE CODE OF 1954



APPENDIX A

Legislative History of Section 167 and Section 168 of the Internal Revenue Code of 1954

SECTION 168

Section 168 was reenacted as part of the Internal Revenue Code of 1954. It permits a taxpayer, such as Panhandle, which has received a certificate of necessity from the designated defense agency, to take a deduction from gross income over a period of 60 months for the amortization of a specified portion of the cost of such facilities. The deduction is in lieu of the normal annual deductions for depreciation during the estimated life of the property.

A. Section 124A

Section 168 was originally enacted as Section 124A of the Revenue Code of 1950, ch. 994, §216(a), 64 Stat. 939. The pertinent language of Section 124A was virtually identical to Section 124 of the 1940 Act which authorized amortization of emergency facilities during World War II. When Section 124A was enacted, the basic objectives of the two statutes were said to be the same:

“* * * The provision is similar to Section 124 of the code which authorized the amortization of emergency facilities during World War II.” S. Rept. No. 2375, 81st Cong., 2d Sess. (1950), 2 U.S. Code Cong. Serv. 3053, 3113 (1950).

“This section of the bill * * * has the same basic objectives as section 124 of the code (relating to the amortization of emergency facilities during World War II) * * *.” *Id.* at 3151.

“In its broad outlines this amendment is similar to the legislation of World War II.” Statement by Senator Gore, Manager of the bill and Chairman of the Senate Finance Committee, 96 Cong. Rec. 13276 (1950).

The Defense Production Administration, which became the certifying authority under Section 124A, presented the Joint Committee on Defense Production with a statement of policy setting forth a similar interpretation of Section 124A. It stated:

"Section 124A of the Internal Revenue Code was included as a part of the Revenue Act of 1950 for the purpose of making available again in the present emergency this means of encouraging the investment of private capital in the expansion of facilities needed for the defense effort." Tax Amortization, Progress Rept. No. 6 of Jt. Comm. on Defense Production, 82nd Cong., 1st Sess. 243 (1951).

B. Section 124

Section 124 was enacted as part of the Second Revenue Act of 1940, ch. 757, §302, 54 Stat. 999. It was clearly intended as an inducement to the investment of private capital in defense facilities. Thus, the Subcommittee of the House Committee on Ways and Means, in reporting Section 124 to the full Committee on August 8, 1940, stated as follows:

"The extension of existing facilities is a necessary and vital part of the national defense program. To obtain the needed facilities will require the investment of hundreds of millions of dollars. * * *

"Your subcommittee, therefore, recommends that a corporation be allowed a deduction for income- and excess-profits tax purposes for the amortization of certain facilities which are certified * * * as necessary in the interest of national defense during the present emergency." Report on Proposed Excess Profits Taxation and Special Amortization by Subcommittee of Committee on Ways and Means, 76th Cong., 3d Sess. 1, 2 (1940).

Senator Harrison, Chairman of the Senate Finance Committee, stated in debate that:

"A very carefully drafted title of this bill relative to amortization of allowances for emergency plants or facilities is included and recommended. This accelerated depreciation allowance was worked out through the joint efforts of the representatives of the National Defense Council, the War and Navy Departments, and the Treasury Department, in cooperation with congressional committees. The sole purpose is the desire of all of us to expand existing facilities which are necessary and vital in our national-defense program." 86 Cong. Rec. 12059 (1940).

During the Senate Finance Committee hearings on this matter, the Chairman of the Committee on Taxation and Finance, Advisory Commission to the Council of National Defense, testified that:

"* * * The sole purpose in recommending this amortization section, which is now a part of the tax bill, was to encourage the use of private capital in the construction of defense facilities.

* * * * *

"* * * This is an encouragement to the use of private capital and to that extent minimizes the drain on Government credit." Hearings on H.R. 10413 Before the Senate Committee on Finance, 76th Cong., 3rd Sess. 166, 169 (1940).

After Section 124 was enacted, Senator LaFollette stated that "amortization acceleration was to be in the nature [of] an inducement * * * [or] benefit extended to the taxpayer * * * in order to get him to go on and expand his facilities." Hearings on Nonreimbursement Certificates (H. J. Res. 257) Before the Senate Committee on Finance,

77th Cong., 2d Sess. 9-10 (1942). See also *Id.* at 4, 5, and 14 (Statements of Under Secretaries of War and Navy).

The statutory provisions for emergency amortization resulted in a tax deferral, not a tax saving. This was clearly stated to the Joint Committee on Defense Production in September, 1952, by the Defense Production Administrator, as follows:

"Another aspect of the program should be emphasized—accelerated amortization is neither an elimination nor reduction but merely a *deferral* of tax liabilities. Aside from unpredictable effects of future changes in tax rates * * *, the only ultimate cost to the Government will be the interest cost on tax receipts postponed under the tax amortization program." Joint Committee on Defense Production, Second Annual Report of Activities, S. Rept. No. 3, 83d Cong., 1st Sess. 52 (1953) (Emphasis supplied).

The emergency amortization provisions make no distinction between regulated and non-regulated companies. Actually, when the 1954 Internal Revenue Code was before the Senate Finance Committee, the FPC advised the Committee that Section 168 (and Section 167) would be applicable to regulated utilities. See *Rapid Amortization in Regulated Industries*, S. Rept. No. 1380, 85th Cong., 2d Sess. 82 (1958).

C. Subsequent History and Amendments

The subsequent legislative history of the emergency amortization provisions includes both FPC Reports to Congress and congressional investigation of the FPC's ratemaking treatment of the benefits from these sections, followed by amendment.

1. In its Annual Reports to Congress, the FPC has called attention to its treatment for ratemaking purposes of what is now Section 168. In its 1954 Report (pp. 118-119), the

FPC discussed its Opinion No. 269 in the Panhandle rate case. It commented that one of the principal issues involved was the "allowance of Federal income taxes and annual depreciation expense for rate-making purposes in view of the accelerated amortization of the cost of certain facilities permitted under section 124A of the Internal Revenue Code * * *." And in its 1956 Report (p. 12), the FPC noted that in the *City of Detroit* decision, this Court upheld the Commission to the effect that temporary tax savings accruing to the company by virtue of accelerated amortization are not for the benefit of consumers.

2. In 1957, the Senate Antitrust and Monopoly Subcommittee of the Committee on the Judiciary undertook an investigation entitled "Rapid Amortization in Regulated Industries." Much of the Antitrust Subcommittee's hearings were devoted to examination of the FPC's decisions that the consumer was not entitled to share in the benefits of Section 168 (and Section 167).

The FPC's position was thoroughly examined during the interrogation of Jerome K. Kuykendall, then FPC Chairman, and Russell C. Rainwater, then FPC Chief Accountant. Chairman Kuykendall left no doubt that utilities re-invested the benefits of rapid depreciation in the investment base upon which they earned their full return. This can be illustrated by the following colloquy between Chairman Kuykendall and Senator Carroll:

"Senator Carroll: * * * Let's get to the question here of the interest-free loan for just a moment, and how you compute it under the recent decision which, as I understand, was confirmed by the circuit court of appeals. That money, this interest-free loan, cannot be applied to reduce the rate base for consumers, that is your decision, and that of the circuit court of appeals; is that not so?

"Mr. Kuykendall: That is correct.

• • • • •

"Senator Carroll: It would not follow, therefore, that the tax deferral money continues to build like yeast and be put into the depreciated reserve. It is plowed back in month after month, year after year, into the capital investment?"

"Mr. Kuykendall: Yes"

"Senator Carroll: . . . My point, Mr. Chairman, I don't think it has been made here, is, where we have no benefit to the consumer, this money which is being constantly used, rotated, plowed back into capital investment, cannot be distributed to the dividend holders, but it does enhance the capital investment, and therefore enhances the value of the stock.

"Mr. Kuykendall: And it increases the rate base of the company.

"Senator Carroll: Exactly." Hearings on Rapid Amortization in Regulated Industries Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 85th Cong., 1st Sess. 421 (1957).

And during a colloquy between Mr. Paul Rand Dixon, then Subcommittee Counsel, and Mr. Willard W. Gatchell, then FPC General Counsel, the Subcommittee specifically focused upon the *City of Detroit* decision:

"Mr. Dixon: . . . It is true, isn't it, that under the holdings of the Federal Power Commission, for instance, in the Panhandle case that has been called to my attention—

"Senator Kefauver: What is the order number and the case number?"

"Mr. Gatchell: It is docket No. G-1116, opinion No. 269, and it is commented upon by the court of appeals in the case cited as *City of Detroit v. Federal Power Commission*, sir. Certiorari was denied, so we do not

have a Supreme Court opinion. But the court of appeals decision is in 230 Federal 2d, 810; certiorari denied (352 U.S. 829, 919).

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"Mr. Dixon: It was held in that case, wasn't it, that the consumer was not meant to benefit from tax amortization? That is true, isn't it?

"Mr. Gatchell: Yes, sir.

"Senator Wiley: What was that, now?

"Mr. Dixon: That the consumer was not meant to benefit by tax amortization.

"Senator Wiley: The public was not to gain?

"Mr. Dixon: That was the holding of the Commission and was approved by the circuit courts, as Mr. Gatchell has pointed out." *Id.* at 923.

The Subcommittee thereafter published on March 12, 1958 its report on the investigation. S. Rept. No. 1380, 85th Cong., 2d Sess. It noted, among other things, that "under the regulations of the Federal Power Commission, as upheld by the courts, it has been held that Congress did not intend consumers to benefit through lower rates as a result of tax amortization but rather that the inducement was intended as a benefit to the electric-utility company" (p. 4. See also pp. 67-68).

In its report (p. 81), the Subcommittee also noted that Senator Kefauver had transmitted his findings "to the chairmen of the Senate Finance Committee and the House Ways and Means Committee * * *." The information was submitted "as of possible interest to the two congressional committees concerned with revenue legislation in their consideration of changes in the revenue statutes."

3. In 1957 Section 168 was amended so as to provide that certificates made after August 22, 1957 should be issued only for facilities to produce new or specialized defense

items for sale to the Defense Department or to the AEC (71 Stat. 414).

4. During the same session of Congress, two bills were introduced to amend the Federal Power Act regarding the treatment of the benefits of Sections 167 and 168. H.R. 5824 and S. 2113, 85th Cong., 1st Sess. (1957). Section 1 of H.R. 5824 provided:

"That the last paragraph of Section 20 of the Federal Power Act (18 USC 813) [Rates of Licensee] is amended by adding at the end thereof the following: 'In determining the value of an item of property of a licensee for purposes of ratemaking, there shall be excluded all amounts allowed to the licensee in the computation of its Federal income tax under sections 167 and 168 of the Internal Revenue Code of 1954.'"

Section 2 of the bill would have added a similar provision to Section 208(a) of the Federal Power Act [Cost of Property].

Although more detailed, S. 2113 was to the same effect. At the outset, it would have added to the Federal Power Act §3 [Definitions] a clause reading: "(17) 'tax savings,' whether called tax savings, tax deferrals, or tax differentials . . . means the tax effect" of Sections 167 and 168. Substantively, it would have amended Federal Power Act §10(d) [Amortization Reserves—Surplus Earnings] to provide that in the determination of earnings, cost of service allowance should reflect deductions claimed for Federal and State income tax purposes. It would have amended Federal Power Act §14 [Compensation on Government Acquisition], 3d sentence, to provide that net investment should not include accumulated tax savings which have not been excluded from cost of service. It would have amended Federal Power Act §20 [Ratemaking] in a manner similar

to that proposed in H.R. 5824. S. 2113 also included other amendments to the Federal Power Act.

Neither bill was enacted.

5. Section 168 was again amended by the Technical Amendments Act of 1958, §9(a)(b), 72 Stat. 1608. These amendments did not affect the basic provisions of the law.

SECTION 167

Section 167 was first enacted as part of the Internal Revenue Code of 1954, 68A Stat. 51. Under Section 167, a taxpayer may elect to depreciate any business property for tax purposes at a faster rate than would be possible under straight-line depreciation. During the early years of an asset's life, liberalized depreciation results in lower federal income taxes than does straight-line depreciation. But since the total depreciable book value of any property is the same no matter what depreciation method is used, during the later years of a property's life liberalized depreciation results in lower depreciation charges, and thus higher taxes, than does straight-line depreciation.

A. Congress Intended to Promote Plant Expansion

1. The legislative history shows that Congress enacted Section 167 to encourage expansion of the nation's productive facilities. In his annual address to Congress (100 Cong. Rec. 571), the President of the United States requested legislation authorizing liberalized depreciation in order to stimulate economic growth:

"A liberalization of the tax treatment of depreciation would have far-reaching effects on all business and be especially helpful in the expansion of small business whether conducted as individual proprietorships, partnerships, or corporations. At present, buildings, equipment, and machinery are usually written off uniformly over their estimated useful lives. The

deductions allowed, especially in the early years, are often below the actual depreciation. This discourages long-range investment on which the risks cannot be clearly foreseen. It discourages the early replacement of old equipment with new and improved equipment. And it makes it more difficult to secure financing for capital investment, particularly for small business organizations.

"I recommend that the tax treatment of depreciation be substantially changed to reduce these restrictions on new investment, which provides a basis for economic growth, increased production, and improved standards of living.

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"Faster depreciation, it should be noted, will merely shift the tax deductions from later to earlier years. It will not increase total deductions. The change should, in fact, increase Government revenues over the years because of the stimulation which it will give to enterprise and expansion."

The same purpose was stressed by the Secretary of the Treasury when he appeared before the Senate Committee on Finance in support of the bill which became the Internal Revenue Code of 1954:

"Another provision of this bill allows more flexible charges for depreciation. . . . Here, again, the purpose is to stimulate employment, plant expansion and modernization." Hearings on the Internal Revenue Code of 1954 Before the Senate Committee on Finance, 83d Cong., 2d Sess. 95 (1954). See also *Id.* at 104 (Statement of Under Secretary of the Treasury).

The Committee reports affirmed that liberalized depreciation was designed as an incentive to plant expansion:

"There is evidence that the present system of depreciation acts as a barrier to investment, particularly

with respect to risky commitments in fixed assets. * * * Under long-run peacetime conditions, in the absence of the inflationary pressures existing in the force-draft economy of the postwar period, present tax depreciation methods might depress business capital expenditures below the level needed to keep the economy operating at high levels of output and employment." H. Rept. No. 1337, 83d Cong., 2d Sess. 22 (1954).

"More liberal depreciation allowances are anticipated to have far-reaching economic effects. The incentives resulting from the changes are well timed to help maintain the present high level of investment in plant and equipment. The acceleration in the speed of the tax-free recovery of costs is of critical importance in the decision of management to incur risk. * * * For all segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living." H. Rept. No. 1337 (p. 24) and S. Rept. No. 1622 (p. 26).

In explaining to the House of Representatives the purpose of Section 167, Congressman Reed, Chairman of the Ways and Means Committee, stated:

"* * * In addition, the changes with respect to depreciation which, for corporations, cost \$300 million in fiscal 1955 not only represent mere shifts in timing, but also are designed to stimulate the economy and broaden the tax base." 100 Cong. Rec. 3421.

"This provision of the bill is anticipated to have far-reaching economic effects. Incentives resulting from the changes are vital in order to help create thousands of new jobs each year and to maintain the present high level of investment in plant and equipment. The bill will make it possible for management to assume risks

which they would otherwise not take. By allowing businesses to recover a large part of their costs more quickly, it will be of particular assistance to growing businesses in financing their expansion. . . .” *Id.* at 3424.

2. Congress intended that this plant expansion should be financed by the additional working capital and temporary tax reductions produced by liberalized depreciation. For example, both committee reports emphasized that:

“ . . . The faster tax write-off would increase available working capital and materially aid growing businesses in the financing of their expansion.” H. Rept. No. 1337 (p. 24) and S. Rept. No. 1622 (p. 26).

Referring in debate to Section 167, the Chairman of the House Ways and Means Committee explained (100 Cong. Rec. 3424):

“ . . . By allowing businesses to recover a large part of their costs more quickly, it will be of particular assistance to growing businesses in financing their expansion.”

And Representative Byrnes made the same point. In explaining a computation, he stated (100 Cong. Rec. 3434):

“ . . . It makes no provision for the additional investment which will be made possible through the added working capital which faster depreciation provides in the form of tax savings. This increase in liquid funds in many instances will make possible the borrowing necessary to finance additional investment.”

Representative Knox also stated in debate (100 Cong. Rec. 3553) that:

“ . . . These tax savings will increase the liquid assets and the working capital position of the business which will be used to reinvest or pay off loans.”

3. During debate, it was also suggested that Section 167 would promote increased investment because industry would gain the benefit not only of increased depreciation deductions, but also of a return on the investment in the new property itself.

This suggestion was made by Representative Byrnes during his illustration of how Section 167 would operate to induce a company to invest \$3500 in new plant equipment having a 20-year life (100 Cong. Rec. 3434). Although he pointed out that Section 167 would increase the company's annual depreciation deductions, Mr. Byrnes explained how this would provide the required incentive only if combined with a return upon the new property itself. As Mr. Byrnes stated:

"If . . . the company could recover 40 percent of its investment, or \$1,400, in the first 5 years, or 65 percent of its investment, or \$2,275, in the first 10 years, the barrier which exists under present policy is removed and obsolete machinery is discarded. The purchase of the new machine means an additional depreciation deduction of \$250 in the first year over the deduction which would have been allowable on the old machine. But the rate of return before taxes on the new investment, perhaps 25 percent or \$875 will far exceed the return on the old machine and the transaction results in additional revenue rather than a loss of revenue."

B. Congress Intended that Regulated Utilities Receive the Benefits of Section 167

1. Section 167 makes no distinction whatever between a regulated and a non-regulated industry. And the legislative history makes it plain that Section 167 is applicable to all tangible and depreciable assets whether owned by a regulated or by a non-regulated business. For example, the House Committee on Ways and Means concluded:

"The liberalized depreciation methods provided in the bill are to apply to *all* types of tangible depreciable

assets, including farm equipment, machinery, and buildings, rental housing, and industrial and commercial buildings as well as machinery and equipment. . . .

“ . . . For *all* segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living.” H. Rept. No. 1337 (pp. 23, 24) (Emphasis supplied).

The Senate Committee on Finance came to the identical conclusion:

“The liberalized depreciation methods provided in the bills are to apply to *all* types of tangible depreciable assets, including farm equipment, machinery, and buildings, rental housing, and industrial and commercial buildings as well as machinery and equipment. . . .” S. Rept. No. 1622 (p. 25) (Emphasis supplied).

And during the debates (100 Cong. Rec. 8997, 8998), Senator Millikin, Chairman of the Committee on Finance, explained Section 167 in these terms:

“The bill, as it passed the House, applies to *all* types of tangible depreciable assets, including farm equipment, machinery and buildings, rental housing, and industrial and commercial buildings, as well as machinery and equipment. . . .

“The new method for depreciation will be available to *all* taxpayers with depreciable property. . . .” (Emphasis supplied).

During the hearings, representatives of electric, gas and telephone utilities emphasized how utilities found the pre-

viously used straight-line method of depreciation unfair to them particularly in view of the declining value of the dollar. Hearings on General Revenue Revision before the House Committee on Ways and Means, 83d Cong., 1st Sess., e.g., pp. 705-9, 725-30, 734-39 (1953).

When the Senate Finance Committee had under consideration the 1954 Code, the FPC on May 7, 1954 called the Committee's attention to the fact that Section 167 (and Section 168) would be applicable to public utilities. See *Rapid Amortization in Regulated Industries*, S. Rept. No. 1380, 85th Cong., 2d Sess. 82 (1958).

2. When Congress decided to allow regulated taxpayers to use Section 167 depreciation procedures, it was aware that the FPC had allowed electric utilities to retain all of the analogous benefits of Section 168. Thus Senator Magnuson had said during debate (100 Cong. Rec. 9596) that:

"* * * [T]he power companies are writing off almost \$3 billion as depreciation on dams built for defense production facilities. If those plants can be written off in 5 years, the savings to the power companies will not be reflected in savings in rates charged to the people."

C. Section 167 Was Understood to Produce a Tax Deferral

Both the Executive and Congress understood that Section 167 results in a tax postponement, not a tax saving. In proposing legislation authorizing liberalized depreciation, the President of the United States said:

"Faster depreciation, it should be noted, will merely shift the tax deductions from later to earlier years. It will not increase total deductions. The change should, in fact, increase Government revenues over the years because of the stimulation which it will give to enterprise and expansion." 100 Cong. Rec. 571. See also the President's Budget Message, 1 U.S. Code Cong. & Ad. News 1557, 1566-67 (1954).

Congress also understood that liberalized depreciation resulted only in a shift in timing of taxes, not in a permanent tax reduction. Thus, referring to the bill which became the 1954 Code, the House committee report said:

"The revenue losses in the bill fall into two main categories: (1) permanent losses and (2) temporary losses which occur because of shifts in the timing of deductions, but with no long-run loss in revenue. * * *"
H. Rept. No. 1337 (p. 2)

"Most of the changes in corporation-income taxation involve shifts in the timing of deductions. The allowance of more rapid depreciation, for example, makes no change in the total amount of depreciation over the life of a building or machine." *Id.* at 3.

"The changes made by your committee's bill merely affect the timing and not the ultimate amount of depreciation deductions with respect to a property."
Id. at 25.

And Congressman Reed, Chairman of the House Ways and Means Committee, stated during debate in the House (100 Cong. Rec. 3421):

"* * * In addition, the changes with respect to depreciation which, for corporations, cost \$300 million in fiscal 1955 not only represent mere shifts in timing, but also are designed to stimulate the economy and broaden the tax base."

Similarly, Congressman Kean stated (100 Cong. Rec. 3528):

"* * * [T]here will be practically no loss to the Treasury in the long run, as writing off machinery faster in the early years means smaller write-offs in later years."

*D. The Subsequent Legislative History Confirms the FPC's
Past Interpretation of Section 167*

Since enactment of Section 167, Congress has been advised on several occasions of the FPC's decisions that the liberalized depreciation provision was intended to benefit natural-gas pipelines, not their customers. Nonetheless, Congress has declined to change the statute in this regard.

The matter was first brought to Congress' notice by the FPC itself. In 1956, when it decided the *Amere* case, the FPC noted in its Opinion that it was "calling this situation to the attention of the Congress by transmitting copies of the presiding examiner's decision, our opinion herein, and the dissenting opinion attached hereto, to the chairman of the Finance Committee of the Senate and the chairman of the Ways and Means Committee of the House." *Amere Gas Utilities Co.*, 15 F.P.C. 781, 782. See also *El Paso Natural Gas Co.*, 22 F.P.C. 260, 266-67.

During later Senate hearings in 1957, Chairman Kuykendall elaborated upon the Commission's action in *Amere*. After quoting the paragraph in the *Amere* decision which states that a copy of the Commission's decision would be transmitted to Congress, Chairman Kuykendall was asked:

"Senator O'Mahoney. Do I understand you to tell the committee that it was not the Federal Power Commission that made the liberalizing order or rule, but the Congress?"

"Mr. Kuykendall. Yes.

"Senator O'Mahoney. And that which you were doing in approving the examiner's decision was merely interpreting the law of Congress, at the request of these petitioners?"

"Mr. Kuykendall. That is right."

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"Senator O'Mohoney [sic]. The point, as I see it, is simply this:

"The majority opinion contains an interpretation of the congressional act, and also a statement referring the matter to Congress, does it not?

"Mr. Knykendall. Yes, We particularly called to Congress' attention what we had done." Hearings on Rapid Amortization in Regulated Industries Before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, 85th Cong., 1st Sess. 439-40 (1957).

As noted in the above discussion of Section 168, the Antitrust and Monopoly Subcommittee's investigation included a full exploration of the decisions of the FPC and of the Court of Appeals that Section 167 (as well as Section 168) was not intended for consumer benefit. The findings of the Antitrust and Monopoly Subcommittee were sent to the chairmen of the Senate Finance Committee and the House Ways and Means Committee. See S. Rept. No. 1380, 85th Cong., 2d Sess. 81 (1958).

Similarly, in its Annual Reports to Congress for 1956 (pp. 75-76) and for 1957 (p. 75), the FPC specifically discussed both its *Amere* decision and amendment of its Uniform System of Accounts to provide for similar treatment of the benefits of both Sections 167 and 168.

In 1957, as noted in the foregoing discussion of Section 168, opponents of the FPC's past treatment of Sections 167 and 168 proposed amendments to the Federal Power Act which would have required the FPC to exclude the tax benefits of the two sections for ratemaking purposes. Neither H.R. 5824 nor S. 2113, however, were enacted.

Thereafter, on September 2, 1958, Congress amended Section 167. Technical Amendments Act of 1958, Title I, § 89 (b), 72 Stat. 1665. It did not, however, make any change in the law to indicate that the Commission had misinterpreted the Congressional intent in its earlier opinions, orders and rulings.

